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DISSERTATION TITLE:

The New Dispensation Governing The Collection of Value Added Tax  
on Electronic Commerce Supplies in South Africa.

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# INTRODUCTION

At the 2013 Budget Speech, the former South African Minister of Finance, Pravin Gordhan made a statement, to the effect that the South African government sought to follow in the footsteps of the European Union and other jurisdictions by proposing that foreign businesses which sell e-books, music and other digital goods and services should be required to register as VAT vendors in South Africa, so as to tax digital goods sold online.<sup>1</sup> This proposal was made in relation to how South Africa's tax revenue base is being depleted by the non-taxation of digital goods and services provided online. Since this proposal was made, the Treasury and South African Revenue Services (SARS) have taken strides to incorporate VAT amendments to the Value Added Tax Act<sup>2</sup> to enforce provisions that would extend the scope of indirect tax collection to non-resident suppliers.

Technology, particularly international, cross border, electronic commerce and the supply of digital services, has created a broader way of thinking than taxation has embraced and continuous application of restrictive tax principles within the limitless environment of the internet can result in a loss of government revenue.<sup>3</sup> The South African Treasury and tax authorities have made the VAT amendments to the VAT Act to allow for efficient tax collection and to address an indirect tax collection system which left room for non-compliance with the law. The VAT amendments do not create new legislation, but specifically address the collection of VAT in international cross border electronic commerce and the supply of digital services to consumers in South Africa.

Value Added Tax, is a type of indirect tax imposed as a direct tax to the final consumer of certain goods and services that are consumed in South Africa.<sup>4</sup> Legislation provides for the levying of tax at 14 per cent or zero rated for certain

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<sup>1</sup> Pravin Gordhan '2013 Budget Speech' available at <http://www.treasury.gov.za/documents/national%20budget/2013/speech/speech.pdf> , accessed 15 April 2013.

<sup>2</sup> Value Added Tax Act 89 of 1991; Taxation Laws Amendment Act 31 of 2013 contains the VAT amendments that address the value added taxation of electronic commerce and electronic services in South Africa.

<sup>3</sup> A Bardopoulos 'Applying Tax Laws is a Tricky Proposition in Cyberspace' available at <http://www.bdlive.co.za/indepth/AfricanPerspective/2013/03/12/applying-tax-laws-is-a-tricky-proposition-in-cyberspace?service> , accessed 22 April 2013.

<sup>4</sup> VAT Act.; Stiglingh Silke: South Africa Income Tax 2013 (2013) 1006.

circumstances, on the supply of goods and services by a registered vendor in the furtherance of an enterprise in South Africa; the importation of goods into South Africa; and the supply of imported services in South Africa.<sup>5</sup> Two methods of indirect tax collection prevail in South Africa, the reverse charge mechanism and the self-assessment mechanism.<sup>6</sup>

The reverse-charge mechanism is incorporated in the VAT Act through the registration of persons that make taxable supplies which exceeded the threshold, in the course or furtherance of an enterprise conducted wholly or partly in South Africa, as VAT vendors or to voluntarily do so.<sup>7</sup> As a VAT vendor, the vendor acts as an agent of the tax authorities by including the VAT value in the price charged for the good or service, collecting that VAT amount, and remitting it to the tax authority.<sup>8</sup> However, these provisions were difficult to apply when dealing with non-resident suppliers as there was no clear definition in the provisions of when a foreign e-commerce supplier can be said to be conducting an enterprise in South Africa and what type of conduct within South Africa is considered to bring the non-resident's activities under the scope of the Act.<sup>9</sup>

The self-assessment system was the primary method used with regard to imported electronic services. The self-assessment system requires that a recipient of imported services to personally declare to the tax authorities the outstanding VAT value of the supply that had been made by a foreign supplier.<sup>10</sup> This system has inherent weaknesses, in that it relied on the honesty of residents, and offered no manner of monitoring.<sup>11</sup> The self-assessment collection method has not been completely eradicated. Instead the legislature has enacted VAT amendments to the VAT Act to specify situations where a non-resident supplier of electronic services in

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<sup>5</sup> Section 7 VAT Act.; L Classen 'E-commerce and Value Added Tax' in S Papadopoulos & S Snail (eds) *Cyberlaw@SA III: The Law of the Internet in South Africa* (2012) 111; C de Wet & R du Plessis 'Taxation (Value Added Tax)' in R Buys & F Cronjei *Cyberlaw@SA II: The Law of The Internet in South Africa* 2ed (2004) 277.

<sup>6</sup> Section 23-26 and section 14 VAT Act.

<sup>7</sup> Section 23-26 VAT Act.

<sup>8</sup> Section 28 VAT Act.

<sup>9</sup> C de Wet & R du Plessis op cit note 5 at 282.

<sup>10</sup> Section 14(1) VAT Act.

<sup>11</sup> National Treasury Media Statement 'Electronic Services Regulations: Request for Public Comments', available at [http://www.treasury.gov.za/comm\\_media/press/2014/2014013001%20-%20Electronic%20Services%20Regulations.pdf](http://www.treasury.gov.za/comm_media/press/2014/2014013001%20-%20Electronic%20Services%20Regulations.pdf), accessed 30 July 2014.

South Africa will be required to register as a VAT vendor and make use of the reverse-charge mechanism.

The primary focus of this paper is on the cross-border supply of electronic services into South Africa by non-resident e-commerce businesses. This paper will discuss the nature of electronic commerce (e-commerce) and electronic services; the impact that e-commerce has on indirect taxes such as value-added tax; the previous legislation and its shortfalls; the nature of the new legislated VAT amendments; the problems that were faced by the tax authorities in its efforts to enact the new tax VAT amendments; the problems that the South African Revenue Services (SARS) may face in enforcing compliance with the new tax legislation; the guidelines that have been put forward by the Organisation for Economic Co-operation and Development (OECD) with regard to international trade over the internet; and the measures that have been put in place in other jurisdictions that directly deal with e-commerce.

Chapter 1 will explain the nature of e-commerce business and its presence in South African business culture, and how it necessitated the VAT amendments to the VAT Act. E-commerce can be defined as the conduct of commerce or business over or in electronic networks, where two parties trade in tangible and intangible products, such as information, voice or visual media, data and services.<sup>12</sup> The growth of this business method has to an extent altered the manner that services can be exchanged in return for remuneration. Certain services are capable of virtual performance and delivery.

E-commerce transactions can occur in the context of business-to-business (B2B), business-to-government (B2G) or business-to-consumer (B2C).<sup>13</sup> Reference will be made to B2B transactions, while the primary focus of this dissertation will be on B2C transactions, as this is where indirect tax issues arose in South Africa. E-commerce creates problems with regard to indirect taxation ascertainment of the

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<sup>12</sup> A W Oguttu "The Challenges that E-commerce Poses to International Tax Laws: Controlled Foreign Company Legislation from a South African Perspective (Part 1)" (2008) 20 *SA Mercantile Law Journal* 348; Department of Communications Republic of South Africa 'Green Paper on E-commerce For South Africa' (2000) 16; De Wet & Du Plessis op cit note 5 at 250.

<sup>13</sup> Department of Communications 'Green Paper' op cit note 12 at 16; De Wet & Du Plessis op cit note 5 at 250.



time of the supply, the place of supply, the nature of the supply and the value of the supply<sup>14</sup>, and this has prompted a global discussion of how to incorporate rules in individual countries that capture this virtual economy.<sup>15</sup>

It shall be discussed what is meant by digitally supplied electronic services and why this specific supply warrants specific inclusion in the VAT Act. E-commerce involves the sale of both goods and services. The sale and delivery of goods has not warranted changes to indirect taxes, as the delivery of the goods utilizes traditional methods of delivery, such as postage services, where VAT and customs and excise can be levied at the port of entry.<sup>16</sup> Further, e-commerce has not changed the delivery of all services, particularly those services that need to be physically performed. However, special consideration is given to the supply of electronic services.

The supply of electronic services can in some instances occur as a once-off supply of digital content in which the consumer acquires digital content that becomes the property of the consumer or it may in other instances be complicated, such as when the digital content is not provided on a once-off basis, and the consumer is, instead, required to pay a monthly subscription fee which allows the consumer to download unlimited content whose value cannot be equated to the monthly subscription fee.<sup>17</sup>

In Chapter 2 the recommendations and frameworks that have been offered by the OECD to deal with the indirect taxation of e-commerce, such as the use of alternate methods to registration, which include a reverse charge mechanism or technology-based systems, where the tax calculation and remittal is undertaken by a trusted third party as part of the online transaction<sup>18</sup> will be referred to, and later, they will be used to weigh up the compliance of the new South African laws in later chapters.

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<sup>14</sup> Classen op cit note 5 at 115; De Wet & Du Plessis op cit note 5 at 277.

<sup>15</sup> OECD 'Electronic Commerce: Facilitating Collection of Consumption Taxes on Business-to-Consumer Cross-Border E-Commerce Transactions' available at <http://www.oecd.org/tax/consumption/1923240.pdf>, accessed 20 April 2013.

<sup>16</sup> National Treasury Media Statement 'Electronic Services Regulations: Request for Public Comments' op cit note 11.

<sup>17</sup> Classen op cit note 5 at 112.

<sup>18</sup> OECD 'Electronic Commerce: Facilitating Collection of Consumption Taxes' op cit note 15.

Chapter 3 will focus on the VAT system in South Africa, and will highlight the old system for the taxing of electronic services when they were generally considered to be imported services and the key aspects of the new system that includes specific provisions dealing with imported electronic services. In the process of discussing the new VAT amendments to the VAT Act, consideration will be had to why the South African Treasury has had to directly address non-resident suppliers of digital content, by analysing the undesirable situation that existed prior to the new legislation. The procedures that have been laid out by the regulations and the enforcement measures that will be utilised by the tax authorities will also be elaborated upon.

Chapter 4 will discuss the new VAT amendments to VAT legislation which requires that non-resident vendors to register as VAT vendors in South Africa despite the lack of physical presence in the country or provision of goods or performance of services personally or through an agent in the country will be addressed. The VAT Act previously only referred to a vendor that is supplying goods or services ‘in the course and furtherance of an enterprise’ wholly or partly in South Africa.<sup>19</sup> A determination of VAT registration liability required a determination of the place of supply and the extent of activity in South Africa, but this is difficult in the electronic world because the internet cannot be easily linked to one physical location and operations can occur over multiple servers located in several jurisdictions.<sup>20</sup> Thus it became necessary that rules of jurisdiction be clarified. The VAT amendments now consider an enterprise as a to include the supply of electronic services, by a person or business outside of South Africa to a recipient in South Africa or where payment for the services comes from a South African bank.<sup>21</sup>

The introduction of these VAT amendments has not been welcomed with open hands and a number of objections were voiced during the drafting process of these new rules by industry stakeholders.<sup>22</sup> Implementation of the proposed

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<sup>19</sup> Section 1 VAT Act.

<sup>20</sup> Watson VAT on Electronic Services and the Fiscus 2014 TaxTalk 15 available at [http://reference.sabinet.co.za.ezproxy.uct.ac.za/webx/access/electronic\\_journals/taxtalk/taxtalk\\_n45\\_a9.pdf](http://reference.sabinet.co.za.ezproxy.uct.ac.za/webx/access/electronic_journals/taxtalk/taxtalk_n45_a9.pdf), accessed 19 July 2014.

<sup>21</sup> The Amendment Act 31 of 2013.

<sup>22</sup> SARS ‘Response Document to the Taxation Amendment Bill 2013’ available at <http://www.sars.gov.za/AllDocs/LegalDoclib/RespDocs/LAPD-LPrep-Resp-2013-02%20-%20Draft%20Response%20to%20SCoF%20on%202013%20TLAB%20and%20TALAB%2011%20Sept%202013.pdf>, accessed 20 July 2014.

registration will not only impose a heavier burden on SARS but also on the non-resident suppliers of digital goods. Concern has been raised as to whether these non-resident suppliers will be willing to comply with the new legislation or will they instead opt to not conduct any business in South Africa.<sup>23</sup> The South African electronic market is not significant compared to that of other countries, and it is questioned whether these new provisions will affect the growth of e-commerce in South Africa. Concern has also been raised as to how this could affect the vendors' expenses and the consumers' prices.<sup>24</sup>

Chapter 5 will focus on how the global nature of e-commerce requires that the taxation policies of one country not be conducted in isolation, and that reference be made to international systems and standards. Buys and Cronje state that “consistency of characterisation between countries and internationally compatible definitions of services that can be delivered online are necessary in providing certainty in the application of consumption taxes, and in minimising the risk of either double taxation or non-taxation of these products.”<sup>25</sup> The European Union which implemented a non-resident supplier system to its VAT regime will be discussed and a comparative analysis will be made between the European System and the new South African system.

The Conclusion will offer a summary of the key aspects of indirect taxation of e-commerce and electronic services and will discuss whether the new measures implemented by the South African tax authorities are sufficient for addressing the shortfalls of the reverse-charge mechanism in South Africa.

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<sup>23</sup> Mawson ‘Digital Tax Misguided’, available at [http://www.itweb.co.za/index.php?option=com\\_content&view=article&id=62111:Digital-tax-misguided-&catid=105](http://www.itweb.co.za/index.php?option=com_content&view=article&id=62111:Digital-tax-misguided-&catid=105) accessed 10 April 2013; Wilson ‘SARS Eyes its Pound of Digital Flesh’, available at <http://www.techcentral.co.za/sars-eyes-its-pound-of-digital-flesh/38552/>, accessed 10 April 2013.

<sup>24</sup> Soverall ‘Digital Tax to Hit Consumers’, available at <http://www.techcentral.co.za/digital-tax-to-hit-consumers/38890/>, accessed 10 April 2013.

<sup>25</sup> De Wet & Du Plessis op cit note 5 at 279.

# CHAPTER 1: ELECTRONIC COMMERCE – WHAT IS IT?

## 1. INTRODUCTION

It is necessary to understand the nature of electronic commerce (e-commerce) and the digital goods and services that are the focus of this paper. E-commerce has transformed the manner in which business contracts, transactions and delivery of goods and services may be completed.<sup>26</sup> Although traditional methods of business which involve direct interaction between a retailer and a customer still exist, e-commerce has removed the physical element with regard to how a retailer conducts business with a consumer.<sup>27</sup> Some instances of e-commerce have also resulted in the delivery of digital products to the purchaser in a non-physical form.<sup>28</sup> This chapter will discuss e-commerce, electronic services, the digital market place that has been created, and the issues that have arisen with regard to taxation of this market place.

### 1.1 ELECTRONIC COMMERCE

E-commerce is a term that is used frequently, but Bardopoulos states that ‘there is not one homogeneous definition of e-commerce. It may cover different technical solutions of conducting business via electronic media such as the internet or mobile telephone or have a more delimited scope.’<sup>29</sup> E-commerce is enabled and relies on the use of Information Communication Technology (ICT),<sup>30</sup> or the internet. The internet is the interconnected system of networks that connects computers around the world using the TCP/IP and includes future versions thereof.<sup>31</sup>

#### 1.1.2. DEFINITIONS OF E-COMMERCE

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<sup>26</sup> ZR Andam E-commerce and E-business (2003) available at [http://www.kau.edu.sa/Files/830/Files/61164\\_Ecommerce%20and%20E%20Business.pdf](http://www.kau.edu.sa/Files/830/Files/61164_Ecommerce%20and%20E%20Business.pdf), accessed 27 May 2013.

<sup>27</sup> CW Chan Taxation of Global E-commerce on the Internet: The Underlying Issues and Proposed Plans (2000) *Minnesota Journal of Global Trade* 233-255 at 234-35; DM Parrilli ‘Electronically Supplied Services and Value Added Tax: The European Perspective’ *Journal of Internet Banking and Commerce* (2009) 14(2) at 2.

<sup>28</sup> YF Lim *Cyberspace Law: Commentaries and Materials* 2ed (2007) 718.

<sup>29</sup> A Bardopoulos *Impact of Technology on Taxation and is VAT the E-Tax Solution* (unpublished PhD Thesis, University of Cape Town, 2012) 57.

<sup>30</sup> Andam ‘E-commerce and E-business’ op cit note 26.

<sup>31</sup> Section 1 Electronic Communications and Transactions Act 25 of 2002.

It is through the use of the internet that retailers bring their products to the attention of the purchaser, conclude a contract of sale with the purchaser, receive payment for the products, or that delivery of the products occurs.<sup>32</sup> E-commerce can be defined generally as commercial transactions that take place over or in electronic networks, where two parties (in the context of business-to-business (B2B), business-to-government (B2G) or business-to-consumer (B2C)) trade in tangible or intangible products online.<sup>33</sup> E-commerce can be defined in a broad or narrow manner. A broad definition would focus on the mere use of the internet to conduct one aspect of a commercial transaction, while a narrow definition would focus on transactions where all aspects of the exchange occurred over the internet.

The South African Green Paper on Electronic Commerce defines e-commerce as:

‘The use of electronic networks to exchange information, products, services and payments for commercial and communication purposes between individuals (consumers) and businesses, between businesses themselves, between individuals themselves, within government or between the public and government and, last, between business and government.’<sup>34</sup>

This definition is narrow because it focuses only on communications or transactions facilitated through the use of the online telecommunications and telecommunication-based tools. The South African e-commerce definition does not include transactions where the exchange of information between the supplier and the consumer is made online, but payment is not made online and delivery is made in physical form.

The OECD defines e-commerce broadly as:

‘The sale or purchase of goods or services, conducted over computer networks by methods specifically designed for the purpose of receiving or placing of orders. The goods or services are ordered by those methods, but the payment and the ultimate delivery of the goods or services do not have to be conducted online. An e-commerce transaction can be between enterprises, households, individuals,

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<sup>32</sup> Chan op cit note 27 at 235.

<sup>33</sup> Oguttu op cit note 12 at 348; Department of Communications RSA ‘Green Paper’ op cit note 12 at 16; De Wet & Du Plessis op cit note 5 at 250.

<sup>34</sup> Department of Communications RSA ‘Green Paper’ op cit note 12 at 16.

governments, and other public or private organisations. To be included are orders made over the web, extranet or electronic data interchange. The type is defined by the method of placing the order. To be excluded are orders made by telephone calls, facsimile or manually typed e-mail.’<sup>35</sup>

This definition is broader than the South African definition as it includes all transactions that involve the use of the internet at any stage. However, by considering both definitions, it becomes apparent that there are two variations of e-commerce and the difference is based on the complete or partial use of the internet to conduct the transaction.

The European Union distinguishes between direct and indirect e-commerce and identifies indirect e-commerce as:

‘the electronic ordering of tangible goods, which still must be physically delivered using traditional channels such as postal services or commercial couriers’;

And direct electronic commerce is:

‘the online ordering, payment and delivery of intangible goods and services such as computer software, entertainment content, or information services on a global scale.’<sup>36</sup>

Indirect e-commerce transactions are still subject to the traditional methods of taxation as the purchased products will have to pass through a customs and excise port of entry and value added tax will be levied by the tax authorities.<sup>37</sup>

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<sup>35</sup> OECD ‘Guide to Measuring the Information Society’ (2011) 72 available at <http://browse.oecdbookshop.org/oecd/pdfs/free/9311021e.pdf>, accessed 28 May 2013.

<sup>36</sup> Jean Monnet Center for International & Regional Economic Law & Justice, The NYU Institutes on the Park Chapter III: Shortcomings of the Present European VAT System with Respect to Electronic Supplies, Classification of E-Commerce Transactions “Shortcomings of the Present European VAT System” available at <http://centers.law.nyu.edu/jeanmonnet/papers/01/013301-03.html>, accessed 16 May 2013 .

<sup>37</sup> Ibid.

Direct electronic commerce, which ‘enables seamless, end-to-end electronic transactions across geographical boundaries exploits the full potential of global electronic markets’,<sup>38</sup> and represents a great challenge to effective VAT administration, especially when it occurs in the context of B2C e-commerce.<sup>39</sup> Direct e-commerce will be the focus of this paper, and further reference to e-commerce in this paper will be to direct e-commerce.

## **1.2 E-COMMERCE AND DIGITAL CONTENT AS DEFINED FOR INDIRECT TAX PURPOSES**

Digital content may be defined as any goods or services that are transferred in an electronic or binary format.<sup>40</sup> The content is digitised in that the information required to have use of the content is converted into a sequence of numbers, which is then sent via the internet or email, and once received, the sequence is converted by the computer and the content is accessible to the consumer.<sup>41</sup> This digital content includes any type of content that can be downloaded from the Internet, such as software, games, mobile applications, videos, MP3s, eBooks, newspapers, magazines, reference material and photographs.<sup>42</sup> This content is intangible because it does not possess physical attributes, even though it may later be transferred onto physical media such as paper, CDs and DVDs. It can be easily transferred to the consumer or business purchasing this content and the sale and supply of digital content can occur within seconds or minutes.

Prior to the VAT amendments there was no definition for digital content in South Africa’s tax legislation. Digital content is referred to in the VAT amendments as ‘electronic services’ as prescribed by the Minister by regulation, and the regulations list several categories of services that may be provided ‘by means of an electronic agent, electronic communication, or the internet for any consideration.’<sup>43</sup>

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<sup>38</sup> Grewlich *Governance in "Cyberspace": Access and Public Interest in Global Communications* (1999) 49.

<sup>39</sup> Van der Merwe “VAT and E-Commerce” (2003) 15 *South African Mercantile Law Journal* at 373.

<sup>40</sup> Johnston “Value Added Tax on Virtual World Transaction: A South Africa Perspective” (2013) 12 (1) *International Business and Economics Research Journal* at 73.

<sup>41</sup> Classen op cit note 5 at 116.

<sup>42</sup> Westin *International Taxation of Electronic Commerce* (2000) 10-13.

<sup>43</sup> Section 1(1) of the Amendment Act 31 of 2013.

The list of electronic services for the purpose of the VAT Act includes online education services; games and games of chance; internet based auction services; miscellaneous services, including e-books, audio visual content, still images and music; and subscription services.<sup>44</sup>

It must be noted that the list of electronic services in the Regulations is limited and does not necessarily encompass all services that are capable of electronic supply, such as transmission or routing of data messages, data processing and storage of data, maintenance and technical support of a website and the supply of software.<sup>45</sup> Although the above services are electronic services in nature they are excluded from the definition of electronic services due to a desire to reduce the administration burden on the tax authorities and foreign suppliers.<sup>46</sup> Further, these electronic services are usually supplied to businesses who are entitled to claim the VAT payable as input tax, therefore, these supplies offer little additional revenue to the tax authorities.<sup>47</sup> However, services not listed in the regulations are still subject to VAT when they are imported from a foreign supplier, and the receiver of the supplier is liable to pay the VAT value to SARS.<sup>48</sup>

The listing of specified electronic services for VAT purposes is not unique to South Africa, as the European Union has a descriptive definition of e-commerce services which states that:

“e-commerce refers to doing business through the electronic processing and transmission of data, text, sound and video; and encompasses many diverse activities including electronic trading of goods and services, on-line delivery of digital content, electronic fund transfers, electronic share trading, electronic bills of lading, commercial auctions, collaborative design and engineering, on-line sourcing, public procurement, direct consumer marketing and after-sales service. It involves both products (e.g. consumer goods, specialised medical equipment) and

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<sup>44</sup> Electronic Services Regulation GN 221 GG37489 of 28 March 2014.

<sup>45</sup> Badenhorst ‘Registration Requirements for Foreign Suppliers of Electronic Services Clarified’, available at <http://taxmansa.co.za/registration-requirements-foreign-suppliers-electronic-services-clarified/>, accessed 30 May 2014.

<sup>46</sup> Ibid.

<sup>47</sup> Ibid.

<sup>48</sup> Section 7(1)(c) Value Added Tax Act.



services (e.g. information services, financial and legal services); traditional activities (e.g. healthcare, education) and new activities (e.g. virtual malls).’’<sup>49</sup>

The European Union has classified digital content as an electronically supplied service (ESS).<sup>50</sup> Such classification follows the recommendation by the OECD that digital products should not be classified as goods.<sup>51</sup>

### **1.3 E-COMMERCE TRANSACTIONS**

E-commerce transactions may occur in different contexts and between different parties. There are three main parties in the electronic market (e-Market), which include businesses, consumers and governments.<sup>52</sup> Since the main focus of this paper is on the VAT registration of foreign internet retailers who sell digital products in South Africa, the discussion here will concern e-commerce transactions which relate to the sale and supply of electronic services between Business-to-Business (B2B), and Business-to-Consumer (B2C). It is important to distinguish between these two types of transactions as different indirect tax rules apply to them.

#### **1.3.1 BUSINESS-TO-BUSINESS (B2B)**

B2B transactions are the exchange of products, services, or information between businesses within industry value chains via an Information Communication Technology-based, computer-mediated network, such as that between a

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<sup>49</sup>Commission of the European Communities ‘A European Initiative in Electronic Commerce’ (1997) available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:1997:0157:FIN:EN:PDF>, accessed 15 May 2013.

<sup>50</sup> De Wet & Du Plessis op cit note 5 at 278; Deloitte available at [http://www.deloitte.com/assets/DcomUnitedStates/Local%20Assets/Documents/Tax/us\\_Tax\\_VAT\\_POV\\_2011Sept\\_100711.pdf](http://www.deloitte.com/assets/DcomUnitedStates/Local%20Assets/Documents/Tax/us_Tax_VAT_POV_2011Sept_100711.pdf), accessed 23 April 2013.

<sup>51</sup> OECD op cit note 15 at 7; Van der Merwe op cit note 39 at 379; Papadopoulos op cit note 5 at 117.

<sup>52</sup> Department of Communications RSA ‘Green Paper’ op cit note 12 at 16; Van der Merwe op cit note 39 at 373; World Trade Organisation ‘Electronic Commerce, Development and Small, Medium-Sized Enterprises’ (2013) 7-8, available at [https://www.google.co.za/url?sa=t&rct=j&q=&esrc=s&source=web&cd=5&cad=rja&uact=8&ved=0CEkQFjAE&url=http%3A%2F%2Fwww.wto.org%2Fenglish%2Ftratop\\_e%2Fdevel\\_e%2Fwksho\\_p\\_apr13\\_e%2Fw193\\_e.doc&ei=IV4QVKTH6aO7QbciIGwCg&usg=AFQjCNGPK3mno2jaxTnHbz oqdJfTSPojw&sig2=T7M4y1S6a1rgBikse3oqSA&bvm=bv.74649129,d.ZGU](https://www.google.co.za/url?sa=t&rct=j&q=&esrc=s&source=web&cd=5&cad=rja&uact=8&ved=0CEkQFjAE&url=http%3A%2F%2Fwww.wto.org%2Fenglish%2Ftratop_e%2Fdevel_e%2Fwksho_p_apr13_e%2Fw193_e.doc&ei=IV4QVKTH6aO7QbciIGwCg&usg=AFQjCNGPK3mno2jaxTnHbz oqdJfTSPojw&sig2=T7M4y1S6a1rgBikse3oqSA&bvm=bv.74649129,d.ZGU), accessed 13 December 2013.

manufacturer and a wholesaler, or a wholesaler to a retailer.<sup>53</sup> Direct online supply of digital services occurs frequently between businesses and represent the bulk of e-commerce transactions.<sup>54</sup> Despite the high number in transactions and value of these transactions, these online transactions and their indirect taxation is considered not to be problematic, as there are compliance and surveillance mechanisms that can be utilised by tax authorities, because businesses tend to be registered entities and can be easily subjected to an audit.<sup>55</sup> Further, rules of self-assessment can be easily applied to B2B transactions.<sup>56</sup>

### **1.3.2 BUSINESS-TO-CONSUMER (B2C).**

Online retail is becoming increasingly popular in South Africa, growing at a rate of 30% a year.<sup>57</sup> B2C transactions entail a business selling products to the public, in general, through online shopping, similar to a general retailer in traditional business models.<sup>58</sup> B2C transactions are less in volume compared to B2B transactions, but they receive the most attention with regard to indirect taxation, due to the ease of evasion of indirect tax liability by consumers.<sup>59</sup> The value of these transactions tends to be small and the products that are purchased are for personal use, the self-assessment mechanism, which is the default mechanism of collecting indirect taxes if a supplier is not required to do, prove to be not adhered to by consumers.<sup>60</sup> Ever since the drafting of the Green Paper on Electronic Commerce in South Africa, the collection of indirect taxes from private individuals has been an area of concern and a matter for further policy consideration.<sup>61</sup>

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<sup>53</sup> Moodley 'The Status of B2B E-Commerce in the South African Manufacturing Sector: Evolutionary or Revolutionary' available at <http://link.wits.ac.za/journal/j0301-sagren-fin.pdf>, accessed 15 May 2013; WTO Committee on Trade and Development op cit note 52 at 7.

<sup>54</sup> Bardopoulos op cit note 29 at 59; WTO op cit note 52 at 7 states that global B2B transactions comprise 90% of all e-commerce.

<sup>55</sup> Van der Merwe op cit note 39 at 373.

<sup>56</sup> Van der Merwe "VAT in the European Union and Electronically Supplied Services to Final Consumers" (2004) 16 *SA Mercantile Law Journal* 577 at 577.

<sup>57</sup> Zeenat Moorad 'E-Commerce Boom Predicted for Next Year' (2012) available at <http://www.bdlive.co.za/business/retail/2012/10/08/e-commerce-boom-predicted-for-next-year>, accessed 30 May 2013.

<sup>58</sup> WTO op cit note 52 at 8; Department of Communications RSA 'Green Paper' op cit note 12 at 16.

<sup>59</sup> WTO op cit note 52 at 8; Bardopoulos op cit note 29 at 59; Van der Merwe op cit note 39 at 373.

<sup>60</sup> National Treasury Media Statement 'Electronic Services Regulations: Request for Public Comments' op cit note 11.

<sup>61</sup> Department of Communications 'Green Paper' op cit note 12 at 41-42.

## **1.4 PROBLEMS POSED BY E-COMMERCE TO INDIRECT TAX**

VAT is a tax that has to be paid by the consumer, either directly to the tax authorities or by a seller who is registered as a VAT vendor and has the responsibility to collect the tax, file and remit tax and maintain tax records.<sup>62</sup> The nature of VAT liability requires knowledge of the time of supply, the value of supply and the place of supply.<sup>63</sup> However, the advent of e-commerce complicates the ascertainment of these VAT aspects. E-commerce has been stated as to pose a challenge to tax authorities for various reasons and these challenges include the anonymous nature of the transactions and taxpayers; the privacy of online payment facilities and the complex web of cross-border multiple jurisdictions.<sup>64</sup>

### **1.4.1. IDENTITY AND LOCATION ISSUE**

The sudden growth in the number of international B2C transactions is considered to pose a problem to indirect tax collection because within the virtual world the ordering and supply of goods means nothing more than a series of digital signs travelling through the global network without geographical and personal identity.<sup>65</sup> These concerns are well founded as it is possible for one of the parties or both parties engaged in the e-commerce transaction to use an untraceable internet site or internet protocol, which can affect the identification of the identity of the consumer or business and their location.<sup>66</sup>

Jones and Basu state that ‘Many on-line shoppers do not feel comfortable giving unnecessary personal information to a web site. Consequently, they may refuse to type it in, shop at a site that does not require it or simply lie.’<sup>67</sup> One of the key attributes of online transactions is that the identification of the consumer is not easily ascertainable and cannot be easily verified. The problem of ascertaining a

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<sup>62</sup> Jones and Basu “Taxation of Electronic Commerce: A Developing Problem” (2002) 16 *International Review of Law Computers and Technology* 37.

<sup>63</sup> De Wet & Du Plessis op cit note 5 at 277.

<sup>64</sup> Classen op cit note 5 at 115; K Siliafis ‘Taxation of E-Commerce: A Task for Jugglers’ (2007) 1 *Masaryk U. J.L & Tech* 141 at 145-6.

<sup>65</sup> Jean Monnet Center for International & Regional Economic Law & Justice, ‘Shortcomings of the Present European VAT System’ op cit note 36.

<sup>66</sup> Limop op cit note 28 at 718.

<sup>67</sup> Jones and Basu op cit note 62 at 38.

person's identity and location is further exacerbated by the fact that documentation as to the digital content purchased is almost non-existent and in some instances it will not be quoted in recognised currency.<sup>68</sup>

#### **1.4.2 CHARACTERISATION ISSUE**

The change in nature of products that can be purchased over the internet has raised concerns when it comes to digital products. This change questions the traditional classification of supplies as goods or services.<sup>69</sup> It has been argued that it is inappropriate for digital content to be classified as goods because these supplies are received by consumers directly from the supplier in an intangible form which is not subject to customs control nor handled in the traditional sense.<sup>70</sup> The debate as to how to classify digital products continues due to the fact that there is no legal authority as to whether the payment to view or download such products are, in whole or in part, payments for the use of, or for the right to use, a copyright on the one hand, or on the other hand, payments for the purchase of goods or services, for some products may incorporate both online and offline elements and be of a hybrid nature.<sup>71</sup>

There is a wide range of digital content that can be made available to a consumer, which vary from those of downloading digital photographs, videos, music, documents and software and storing it in an electronic device, to those that give the consumer the ability to view visual and hear audio digital content online, store electronic data online and use of software online, on the other hand, and this makes automatic classification as a 'service' contentious.

#### **1.4.3 ENFORCEMENT ISSUES**

The intangible nature of these products complicates the ascertainment of where and when the transactions took place by obscuring the origin and destination details and the assessment of tax liability of traders based on the comparison of inputs and

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<sup>68</sup> Lim op cit note 28 at 718.

<sup>69</sup> Jean Monnet Center for International & Regional Economic Law & Justice 'Shortcomings of the Present European VAT System' op cit note 36.

<sup>70</sup> OECD op cit note 15 at 20-21.

<sup>71</sup> De Wet & Du Plessis op cit note 5 at 278; Classen op cit note 5 at 116; Van der Merwe op cit note 39 at 379.

outputs.<sup>72</sup> In instances where the tax authorities are aware of an e-commerce transaction, another issue arises with regard to who should be liable to account for the VAT due. Van der Merwe argues that “where the receiver within the jurisdiction of a specific country is an unidentifiable private consumer or unregistered business, it is often impossible to enforce VAT payment on taxable transactions. Were one to provide that the supplier assumes the responsibility for paying VAT, it becomes difficult to enforce such a provision if the supplier is beyond the fiscal jurisdiction of Revenue authority where consumption takes place.”<sup>73</sup> In some instances it is not the supplier’s fault, but as mentioned above, it is due to a failure in ascertaining the tax status and the location of their customers, to allow them to discharge their administrative and payment obligations properly.<sup>74</sup>

Due to lack of uniformity in VAT liability rules internationally, suppliers may be uncertain as to their tax liability, and this may result in a failure to plan their taxes correctly and to make the required arrangements.<sup>75</sup> Confusion would arise where one jurisdiction applies an origin principle, which levies VAT on exports, and where another jurisdiction levies VAT on imports under the destination principle. In such a case the supply would have VAT levied on it twice.

The direct interaction between the trading parties has the effect of removing intermediaries to process the transaction, such as banks, financial institutions, agents, sales organisations or warehousing facilities, and leads to difficulties for the tax authorities in trying to obtain the necessary documentation or records and conducting audits on the suppliers.<sup>76</sup> Information of non-resident vendors’ business finances may not be readily available to determine the entity’s annual turnover.<sup>77</sup>

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<sup>72</sup> Limop cit note 28 at 719; K Siliadis op cit note 64 at 146.

<sup>73</sup> Van der Merwe op cit note 39 at 381.

<sup>74</sup> The Jean Monnet Center for International & Regional Economic Law & Justice ‘Shortcomings of the Present European VAT System’ op cit note 36.

<sup>75</sup> Classen op cit note 5 at 115.

<sup>76</sup> Lim op cit note 28 at 718; Siliadis op cit note 64 at 147; Moss Holdstock ‘E-Services and Looming VAT Dragons’ Tax Alert 24 May 2013, available at <http://www.cliffedekkerhofmeyr.com/export/sites/cdh/en/news/publications/2013/tax/downloads/Tax-Alert-24-May-2013.pdf>, accessed 26 May 2013.

<sup>77</sup> Classen op cit note 5 at 113.

The cost of implementing tax collection and compliance is another problem that is faced by tax authorities.<sup>78</sup> It gives rise to a question of whether the costs outweigh the non-taxation. The internet is vast and decentralised.<sup>79</sup> Advanced technology would be required to keep abreast of all transactions that occur on the internet and this requires an extra cost of research and development to be incurred by the tax authorities.

#### **1.4.4 INTERNATIONAL CROSS BORDER ISSUE**

The taxation of imported digital products is not unwarranted as importation of these products in physical form (hard copy books and CD-ROMs) would be liable to indirect taxes at the port of entry and the supply of these goods and services from a local vendor would also be liable for value added tax.<sup>80</sup> Inadequate taxation of imported digital goods has the effect of resulting in discrepancies in market competition where foreign suppliers do not charge VAT, while do.<sup>81</sup> For example, when Kalahari.com, a South African e-retailer charges VAT to its South African consumers,<sup>82</sup> while no VAT is charged by international suppliers such as Amazon.com, an American e-retailer, for a similar purchase by a local consumer, as Amazon.com's retail price would not include an extra 14% amount as that charged by local suppliers.

#### **1.5 CONCLUSION**

E-commerce in general involves the conducting of traditional business transactions through the internet. However, due to the international and cross-border nature of the internet, electronic markets have been formed in a borderless environment where traditional jurisdictions of tax authorities are not clear. E-commerce can occur in a direct manner, which involves the direct supply of digital products to businesses and consumers. Such transactions can be identified as problematic to the traditional collection of indirect tax by tax authorities, and the manner in which these problems

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<sup>78</sup> Pastukhov "Going Where No Taxman Has Gone Before: Preliminary Conclusions and Recommendations Drawn from the Decade of Debate on the International Taxation of E-commerce" (2009-2010) 36 *Rutgers Computer and Technology Law Journal* 1 at 10.

<sup>79</sup> Westin op cit note 42 at 5.

<sup>80</sup> Section 7(1) of VAT Act.

<sup>81</sup> Jones & Basu op cit note 62 at 37.

<sup>82</sup> Kalahari Website, available at <http://www.kalahari.com/help/help.aspx>, accessed 16 May 2013.

should be addressed is unclear. However, e-commerce and digital products should not evade taxation and the same treatment accorded to traditional methods should be applied.<sup>83</sup> Although e-commerce is different, it does not require the enactment of separate legislation and it should be incorporated into the current tax laws.<sup>84</sup> A discussion of the current indirect tax laws of South Africa is necessary and this will be the topic of discussion in the next chapter.<sup>85</sup>

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<sup>83</sup> Pastukhov op cit note 78 at 10.

<sup>84</sup> Siliakis op cite note 64 at 144.

<sup>85</sup> Chapter 3 below.

# CHAPTER 2: THE ORGANISATION OF ECONOMIC CO-OPERATION AND DEVELOPMENT – RECOMMENDATIONS ON HOW TO DEAL WITH E-COMMERCE FOR INDIRECT TAXATION PURPOSES

## 1. INTRODUCTION

The indirect taxation of e-commerce is an international concern due to the ease of cross-border transactions inherent in B2C supplies of digital products.<sup>86</sup> The Organisation for Economic Co-operation and Development (OECD) has played a significant role in facilitating discussions on, and developing guidelines and possible solutions to the task of indirectly taxing e-commerce by tax authorities.<sup>87</sup> They have issued recommendations on how this can be done and continues to monitor the situation. The discussion in this chapter will highlight the recommendations and frameworks offered by the OECD and what steps it recommends for tax authorities that wish to indirectly tax e-commerce.

### 1.1. BACKGROUND OF THE OECD

The OECD was created in 1961 and its membership has increased to 34 member states. It also has agreements for enhanced engagement programmes and observer status with Brazil, China, Indonesia, and South Africa.<sup>88</sup> Despite having a small number of members, the OECD has actively involved non-member countries with diverse economies and tax policies in the debate of e-commerce and taxation. It has also placed a central role in developing guidelines on the most effective methods of dealing with the issues that arise.

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<sup>86</sup> OECD 'Consumption Guidance Series' (2003), available at <http://www.oecd.org/ctp/consumptiontax/consumptiontaxguidanceseries.htm>, accessed 3 August 2013.

<sup>87</sup> OECD 'What We Do and How', available at <http://www.oecd.org/about/whatwedoandhow/>, accessed 30 July 2013.

<sup>88</sup> OECD 'Membership and Partners', available at <http://www.oecd.org/about/membersandpartners/>, accessed 30 July 2013.



As mentioned above South Africa plays an active role in the OECD despite not being a member. De Swardt and Oberholzer state that it is prudent to consider the OECD principles on e-commerce when evaluating South African VAT legislation.<sup>89</sup> The principles that pertain to taxing e-commerce as developed by the OECD were stated in the South African Green Paper to be the guidelines that South Africa would use in dealing with the issues that e-commerce raises in South Africa.<sup>90</sup>

## **1.2. THE OCED OTTAWA CONFERENCE 1998**

The OECD first engaged with the issue of e-commerce taxation at the Ottawa Conference in 1998 and the primary issue on the agenda was how to implement tax policies and procedures without distorting the new and traditional economies.<sup>91</sup> It was agreed on that the tax provisions that apply to conventional commerce should also apply to e-commerce and this eliminated the possibility that e-commerce would become tax free, or that governments could impose a discriminatory tax on e-commerce.<sup>92</sup> The Committee on Fiscal Affairs (CFA) drafted the Electronic Commerce Taxation Framework Conditions (Framework Conditions), which propose that countries should implement rules that deal with the characterisation of digital products and the place of supply of these products and that legislatures should be guided by the broad taxation principles of neutrality, efficiency, certainty and simplicity, effectiveness and fairness, and flexibility.<sup>93</sup>

The Framework Conditions that were agreed to were, firstly, the rules for consumption taxation of cross-border trade should result in taxation in the jurisdiction where consumption takes place, secondly, the supply of digitised

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<sup>89</sup> De Swardt & Oberholzer 'Digitised Products: How Compliant is South African Value-Added Tax?' *Meditari Accountancy Research* (2006) 14(1) 15-28 at 16; Charlet & Buydens 'The OECD International VAT/GST Guidelines: Past and Future' *World Journal of VAT/GST Law* (2012) 1(2) 175-184 at 177.

<sup>90</sup> Department of Communications 'Green Paper' op cit note 12.

<sup>91</sup> OECD 'A Borderless World: Realising the Potential of Electronic Commerce' 8 October 1998, available at [http://www.biac.org/members/tax/BEPS/Ottawa\\_tax\\_Framework\\_923256.pdf](http://www.biac.org/members/tax/BEPS/Ottawa_tax_Framework_923256.pdf), accessed 12 March 2013.

<sup>92</sup> De Swardt & Oberholzer op cit note 89 at 18.

<sup>93</sup> OECD 'A Borderless World: Realising the Potential of Electronic Commerce' 8 October 1998, available at [http://www.biac.org/members/tax/BEPS/Ottawa\\_tax\\_Framework\\_923256.pdf](http://www.biac.org/members/tax/BEPS/Ottawa_tax_Framework_923256.pdf), accessed 12 March 2013; Charlet & Buydens op cit note 89 at 178 states that 'Contrary to national or regional legislation, the aim of the OECD Guidelines is not to provide detailed rules for the application of consumption taxes but rather a set of 'soft law' principles for the application of VAT to cross-border trade. Although they do not have legal force, the Guidelines will set out principles that the OECD member countries are encouraged to follow.'

products should not be treated as a supply of goods, and lastly, a reverse-charge, self-assessment mechanism should be used where businesses and other organisations within a country acquire services and intangible property from outside the country.<sup>94</sup> Thereafter the CFA adopted a number of guidelines which are contained in the Consumption Tax Guidance Series<sup>95</sup> In an effort to create an international framework, the OECD adopted the International VAT/GST Guidelines.<sup>96</sup>

These Guidelines do not have binding force and act as a roadmap that governments and legislators can use while drafting e-commerce domestic tax law.<sup>97</sup> More work has been done and several drafts have been published but have not yet been adopted. The Guidelines are being developed in stages and all subsequent documents function as building blocks which will form a complete set of Guidelines in the near future.<sup>98</sup> The earlier Consumption Tax Guidance Series will be used to elaborate on matters that the International VAT/GST Guidelines does not expand on, and the subsequent developments made in current draft Guidelines will be discussed below.

## **2. GUIDELINES OFFERED BY THE OECD WITH REGARD TO ASPECTS OF INDIRECT TAXATION OF E-COMMERCE**

### **2.1. GUIDELINES ON THE CHARACTERISATION OF DIGITAL PRODUCTS AND INTANGIBLES**

The OECD has recommended that digital content and intangibles should not be regarded as a supply of goods.<sup>99</sup> It has thereafter referred to digital content as supplies of “services and intangibles”. No clear explanation has been advanced as to how digital products should be classified.<sup>100</sup> The primary focus of the OECD has been on the place of supply and the determination of jurisdiction to levy tax by countries.

### **2.2. GUIDELINES ON DEFINING THE PLACE OF**

<sup>94</sup> OECD ‘A Borderless World: Realising the Potential of Electronic Commerce’ op cit note 91.

<sup>95</sup> OECD ‘Consumption Guidance Series’ op cit note 86.

<sup>96</sup> OECD ‘International VAT/GST Guidelines’ (2006) 10, available at <http://www.oecd.org/ctp/consumptiontax/36177871.pdf>, accessed 12 August 2013.

<sup>97</sup> Charlet & Buydens op cit note at 178.

<sup>98</sup> Ibid at 179.

<sup>99</sup> OECD ‘A Borderless World: Realising the Potential of Electronic Commerce’ op cit note 91.

<sup>100</sup> Classen op cit note 5 at 117.

## **CONSUMPTION**

For the purpose of creating certainty and avoiding double taxation or unintentional non-taxation, it was proposed that member and non-member countries should have rules that make the place of supply, the place where consumption takes place.<sup>101</sup>

Uniformity of rules would result in the services subject to the transaction only being taxed in the jurisdiction of the recipient of the services. However, the OECD noted that a pure consumption principle was burdensome as it would be difficult for suppliers and tax administrators to determine where exactly the services had been consumed and it applied proxies in relation to the place of consumption in B2B and B2C transactions.<sup>102</sup>

The place of consumption for B2B transactions is in the jurisdiction in which the recipient has located its business presence.<sup>103</sup> The contract giving rise to the transaction may be used to determine the jurisdiction of the recipient business. This is referred to as the “The Main Criterion/Rule” and it acts as a proxy to the pure consumption test. The Guidelines, however, allow for the use of different criterion to determine the actual place of consumption if the application of the main criterion would result in distortion of competition or avoidance of tax.<sup>104</sup>

The pure consumption test may be used in instances where services acquired by an entity in one jurisdiction are utilised by one or more entities that are located in other jurisdictions. Here the tax authorities in the other jurisdictions are permitted to apply a pure consumption test and recover the tax that is proportionate to the actual consumption taking place in that jurisdiction.<sup>105</sup> This is called the “Overriding Criterion/Rule”.<sup>106</sup>

However, no further work has been done on the clarification of the definition of “business presence” as it is no clear whether it refers to a dominant presence, a degree of presence or a fixed place of business.<sup>107</sup>

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<sup>101</sup> OECD ‘International VAT/GST Guidelines’ (2006) op cit note 96 at 10.

<sup>102</sup> Ibid at 10-11.

<sup>103</sup> Ibid at 10. A business establishment includes headquarters, registered office or a branch of the business, denotes a business as having its business presence in a particular jurisdiction.

<sup>104</sup> Ibid.

<sup>105</sup> Ibid.

<sup>106</sup> Ibid.

<sup>107</sup> Classen op cit note 5 at 118.

The place of consumption for B2C transactions is the jurisdiction in which the recipient has their usual residence, and if there is more than one place of residence, then the place that the recipient spends majority of their time.<sup>108</sup> The concept of 'usual residence' is not defined by the OECD or explained further in published documents.<sup>109</sup> Therefore the rules do not necessarily refer to where the supply is actually consumed but considers place of residence, as this is the most practicable option in e-commerce.<sup>110</sup>

The Guidelines do not apply to services that cannot be delivered directly from a remote location nor those that are performed physically or in relation to immovable property.<sup>111</sup>

### **2.3. GUIDELINES ON COLLECTION MECHANISMS**

Collection methods that can implement the above place of supply principles have been recommended by the OECD. Since collection of tax by custom's authorities when there is a supply of services is impossible, the OECD recommended that the remaining two of the three traditional methods for tax collection be used. These methods are the reverse-charge/self-assessment mechanism and registration of the supplier as a vendor.<sup>112</sup> These methods were identified as the logical starting points while waiting new technological methods to be discovered. Different collection methods are recommended for B2B and B2C transactions.

For B2B transactions the reverse-charge mechanism was recommended as the appropriate collection method where it is consistent with the overall design of the national tax system.<sup>113</sup> The OECD justified the use of this method for these transactions on the basis that it was an effective way for tax authorities to verify and enforce compliance; the compliance burden on the non-resident supplier was minimal; and because it reduced the risks that may arise when a non-resident supplier is required to collect tax whether or not that vendor's customers are entitled to deduct the tax or recover it through input tax credits.<sup>114</sup>

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<sup>108</sup> OECD 'International VAT/GST Guidelines' op cit note 96 at 11.

<sup>109</sup> Classen op cit note 5 at 119.

<sup>110</sup> De Swardt & Oberholzer op cit note 89 at 20.

<sup>111</sup> OECD 'International VAT/GST Guidelines' op cit note 96 at 11.

<sup>112</sup> Ibid at 12.

<sup>113</sup> Ibid.

<sup>114</sup> Ibid.

The OECD acknowledges that technology based collection methods would benefit the collection of indirect tax on B2C the most, but until such a time, it recommended that where countries consider it necessary a registration system of non-resident suppliers should be considered.<sup>115</sup> The situations in which registration may be necessary by a tax authority, include where there is potential for distortion of competition or significant present or future revenue loss, a registration system.<sup>116</sup>

The registration system must impose a minimal compliance burden on the non-resident supplier so as to be consistent with the principles of effectiveness and efficiency.<sup>117</sup> This can be achieved through implementing a simplified registration system. Non-discriminatory registration thresholds and appropriate control and enforcement measures were also recommended.<sup>118</sup>

## **2.4. GUIDELINES ON TAX ADMINISTRATION**

### **2.4.1. SIMPLIFIED REGISTRATION**

The implementation of a registration system for the purposes of indirectly taxing e-commerce and the supply of digital services involves the balancing of two important interests, namely that of not imposing an unreasonable compliance burden on non-resident businesses and ensuring that the tax authorities have enough control to enforce non-compliance by non-resident businesses. As e-commerce is premised on the use of the internet, the OECD put emphasis on the use of electronic means when formulating a registration system.<sup>119</sup>

Electronic access on the website of the jurisdiction's tax authorities and online registration applications are recommended. The information that would be required from a prospective non-resident vendor would include the name of the business, postal and/or registered address of the business and its contact person, telephone number of the contact person, electronic address of the contact person, website URL of the business, and the national tax identification number of the non-resident vendor in their host country.<sup>120</sup>

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<sup>115</sup> Ibid at 13.

<sup>116</sup> Ibid.

<sup>117</sup> Ibid.

<sup>118</sup> Ibid.

<sup>119</sup> OECD 'Consumption Tax Guidance Series: Paper 2: Simplified Registration Guidance' (2003), available at <http://www.oecd.org/ctp/consumption/5590980.pdf>, accessed 23 August 2013.

<sup>120</sup> Ibid.

Where online registration has been processed, it is recommended that the tax authority make use of online declarations for non-resident vendors.<sup>121</sup> Simplified electronic filing procedures and reasonable periods for doing so are advised as necessary so as to limit the compliance burden of non-resident vendors as they are likely to have several jurisdictions that they have tax obligations in.<sup>122</sup> Record-keeping requirements are to be of a nature that allows for review by the tax authorities and should permit electronic storage. The OECD acknowledges that different countries have different rules with regard to record-keeping, particularly with respect to VAT invoice format, the use of electronic documents and language requirements, and it calls for the development of a standardised format that would be internationally applied.<sup>123</sup>

#### **2.4.2. VERIFICATION OF CUSTOMER'S STATUS AND JURISDICTION**

The ability to verify the jurisdiction of the customer, and the status of the customer as a VAT registered or a private person is central to effective and efficient indirect taxation collection.<sup>124</sup> A non-resident vendor needs to be aware of the country that the customer has a business presence or usually resides, for the non-resident vendor to process the transaction in terms of the tax legislation that applies in that jurisdiction. In a situation where both methods of reverse-charge and registration are employed by a tax jurisdiction, the non-resident vendor needs to be able to verify the status of the customer so as to either shift the tax burden (in the case of a business customer) or to collect and remit the tax (in the case of a private consumer).

##### **2.4.2.1. Establishing and Verifying Status and Jurisdiction of a Business Customer.**

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<sup>121</sup> Ibid.

<sup>122</sup> Ibid.

<sup>123</sup> Ibid.

<sup>124</sup> OECD 'Consumption Tax Guidance Series: Paper 3: Verification of Customer Status and Jurisdiction' (2003), available at <http://www.oecd.org/ctp/consumption/5574687.pdf>, accessed on 13 August 2013.

The 'business agreement' has been identified as a useful instrument in the determination of the jurisdiction of a business customer.<sup>125</sup> When dealing with a business customer the guidelines provide that in addition to a customer declaration, either registration number verification, other indica, or digital certificates should be used to verify the business status of the customer.<sup>126</sup> Verification of registration numbers may be undertaken when there is a VAT/GST registration database in which the validity of the VAT registration number that is supplied by the customer can be checked.<sup>127</sup> However, this may be difficult to implement in every jurisdiction and in a global environment.

It is suggested that in cases where the verification system cannot provide an efficient service that a computation system be used as an alternative.<sup>128</sup> It is recommended that when either the online or computation systems are used, that they be accompanied by the use of other indica in determining the status and jurisdiction of a customer.<sup>129</sup>

The indica that may be of use includes payment system data and the nature of the supply. When the customer makes a payment, the credit card information and the bank transfer details that are supplied by the customer may be of use.<sup>130</sup> The nature of the supply can be used to make inferences as to the status of the customer as some supplies by their nature would not be generally used for business purposes.<sup>131</sup> However, some supplies do not lend themselves easily to making presumptions by the supplier as some services may be used by both business and private customers.

Digital certificates are another instrument that may be used for the determination of the status and jurisdiction of a customer. They are currently used in some jurisdictions for B2G transactions and have been issued by some companies to

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<sup>125</sup> OECD 'International VAT/GST Guidelines' op cit note 96 at 10, explains that 'The business agreement is not limited to a contract and reference can be made to general correspondence, purchase orders, invoices, payment instruments and receipts.'

<sup>126</sup> OECD 'Consumption Tax Guidance Series: Paper 3: Verification of Customer Status and Jurisdiction' (2003) at 3, available at <http://www.oecd.org/ctp/consumption/5574687.pdf>, accessed on 13 August 2013

<sup>127</sup> Ibid at 4. The efficiency of this depends on the ability of the verification system to validate the number in real time or in a timely manner.

<sup>128</sup> Ibid. This system allows for validation of the whether a registration number is genuine or not.

<sup>129</sup> Ibid at 5.

<sup>130</sup> Ibid. However, the information that can be gathered from credit payments is minimal as customer privacy concerns are involved and the card holder's details cannot be computed.

<sup>131</sup> Ibid.

their customers.<sup>132</sup> It would be reasonable that these digital certificates be issued by the tax authorities themselves so as to create certainty.

As there are different mechanisms in use when a supplier attempts to identify the status and jurisdiction of a business customer, there is potential for the supplier to identify that the customer's information does not correspond to their declaration. In such instances the supplier may need to refer to further guidelines supplied by the domestic tax authorities, and it is recommended that the supplier should be allowed to presume that the customer is a private customer where there is a mismatch.<sup>133</sup>

#### **2.4.2.2. Establishing the Jurisdiction of a Private Customer**

The jurisdiction of a private consumer may be established on the private consumer's self-declaration as a private customer, payment information, geolocation, and digital certificate. Declarations by a private consumers without verification offer limited reliability.<sup>134</sup> To remedy this, false declarations may be criminalised in terms of domestic legislation but the address details that are supplied by the consumer can be used in conjunction with other *indica* to verify the jurisdiction of the consumer.<sup>135</sup>

The payment information that is supplied by the consumer may offer confirmation of the consumer's jurisdiction if it includes a billing address. The Internet Protocol (IP) address of the consumer may be used to trace the consumer's geolocation through the use of specialised software which compares the IP number to a database of geographically know IP numbers.<sup>136</sup> Such software is relatively cheap and can be easily incorporated into the supplier's website's transaction system. The nature of the supply can be used to determine the destination of the supply by looking at the language, content and currency of the supply. Digital certificates can also be used, but they are not widely used by private consumer. The OECD identifies digital certificates as the best option and as a long term solution.<sup>137</sup>

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<sup>132</sup>Ibid at 6. They would offer a reliable and real time validation mechanism as they can be easily authenticated.

<sup>133</sup>Ibid.

<sup>134</sup>Ibid.

<sup>135</sup>Ibid.

<sup>136</sup>Ibid at 7.

<sup>137</sup>Ibid.



### 3. **CONCLUSION**

The OECD<sup>138</sup> has conducted a lot of research on indirect taxation of e-commerce and it has developed guidelines to aid countries in their endeavours to tax e-commerce. However, because the guidelines provided are 'soft law' in nature, their adoption by non-member countries is questionable. Further, the fact that majority of the world's countries are not members may have an impact on the adoption of these rules. It is also questionable how these guidelines would apply in practice as they offer a basic framework and do not offer sufficient interpretation guidelines for application.

The guidelines are still a work in progress and technological mechanisms that seem necessary for the efficient application of the recommended rules are yet to be developed. It is questionable whether these rules will achieve the results sought until these mechanisms have been developed. Another aspect of these rules that appears to be lacking in the guidelines is how these rules will be enforced by tax authorities, especially with regard to the simplified registration system. It is presumed that the next future guidelines that are currently being worked on by the OECD will give clarity to this issue.

The OECD has suggested that a simplified electronic procedure can be used to register non-resident suppliers for B2C online transactions in circumstances when it is necessary. B2C online transactions usually form a small percentage of most countries' e-commerce markets. Therefore its adoption is likely to occur in countries that have a high percentage of B2C online transactions, such as the European Union. South Africa's decision to introduce a simplified registration system in line with the OECD guidelines may have been spurred by both of the above reasons as South Africa is one of the few countries that the OECD engages with in the development of these policies. Their practical application is yet to be seen.

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<sup>138</sup>OECD 'Consumption Tax Aspects of E-commerce: A Report From Working Party No. 9 On Consumption Taxes To The Committee On Fiscal Affairs' (2001), available at <http://www.oecd.org/ctp/consumption/2673667.pdf>, accessed 26 June 2013.



# CHAPTER 3: VALUE ADDED TAX IN SOUTH AFRICA AND COLLECTION MECHANISMS

## 1. INTRODUCTION

The primary focus of this paper is on the cross-border supply of electronic services into South Africa by non-resident e-commerce businesses. The relevant instance of VAT imposition is that of section 7(1) of the Value Added Tax Act (The VAT Act),<sup>139</sup> which concerns the levying of VAT on goods and services consumed in the Republic of South Africa. A discussion of the VAT system of South Africa is necessary so as to fully understand the changes that have been introduced by the VAT amendments to address e-commerce VAT collection in South Africa. The South African Revenue Services (SARS) states that, generally a VAT-type tax possesses essential characteristics which include, firstly, the tax applies generally to transactions related to goods and services, it is proportional to the price charged for the goods and services, it is charged at each stage of the production and distribution process, and the taxable person (vendor) may deduct the tax paid during the preceding stages, placing the burden of the tax on the final consumer.<sup>140</sup>

## 2. THE VALUE ADDED TAX SYSTEM

VAT is an indirect tax that is charged on the final consumer for the consumption of a supply of goods or services from a registered vendor.<sup>141</sup> VAT is imposed by the VAT Act in instances where there is a supply of goods and services by any vendor in the furtherance of an enterprise in South Africa; the importation of goods into South Africa; and the supply of imported services in South Africa.<sup>142</sup> The South African VAT system provides for three methods of VAT collection. The first is the vendor registration system provided for in section 23 of the VAT Act, which is

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<sup>139</sup> VAT Act.

<sup>140</sup> SARS 'Guide for VAT Vendors' 9 Available at:

<http://www.sars.gov.za/AllDocs/OpsDocs/Guides/VAT%20404%20-%20Guide%20for%20Vendors%20-%20External%20Guide.pdf>, accessed 12 June 2013.

<sup>141</sup> Stiglingh op cit note 4 at 1007.

<sup>142</sup> Section 7 VAT Act.; Classen op cit note 5 at 111; De Wet & Du Plessis op cit note 5 at 277; Stiglingh op cit note 4 at 1014.

applied where a taxable person is carrying on an enterprise in South Africa in terms of section 7(1)(a).<sup>143</sup> The second method is the levying of VAT before goods are cleared at customs by the port authorities when goods are imported into South Africa in terms of section 13 of the VAT Act.<sup>144</sup> The third method of collection is the self-assessment method which is provided for in section 14 of the Act, which is applied when services are imported from a non-resident supplier.<sup>145</sup>

VAT is levied under the VAT Act at a standard rate of 14 per cent or 0 per cent on taxable business transactions of supplies of goods or a service by a vendor.<sup>146</sup> VAT is levied on all supplies at the above rates unless the supply is one of those listed by the VAT Act as exempt supplies.<sup>147</sup> The time of supply determines the tax period that the tax must be accounted; the value of the supply determines the amount of tax that should be collected; and the place of the supply determines which tax authorities have the jurisdiction to receive the tax.<sup>148</sup> The VAT charged by the vendor on the supply of goods or services in the course of conducting any enterprise is known as Output tax<sup>149</sup>, and it is this output tax that the vendor must pay over to the tax authorities.<sup>150</sup> These aspects of the VAT system will be discussed extensively below.

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<sup>143</sup> VAT Act.

<sup>144</sup> VAT Act.

<sup>145</sup> VAT Act.

<sup>146</sup> Section 7 VAT Act. provides:

‘Subject to the exemptions, exceptions, deductions and adjustments provided for in this Act, there shall be

levied and paid for the benefit of the National Revenue Fund a tax, to be known as the value-added tax-

(a) on the supply by any vendor of goods or services supplied by him on or after the commencement date in

the course or furtherance of any enterprise carried on by him;

(b) on the importation of any goods into the Republic by any person on or after the commencement date; and

(c) on the supply of any imported services by any person on or after the commencement date, calculated at the rate of 14 per cent on the value of the supply concerned or the importation, as the case may be.’

<sup>147</sup> Section 12 VAT Act.

<sup>148</sup> De Wet & Du Plessis op cit note 5 at 277.

<sup>149</sup> Section 1 VAT Act. provides: ‘output tax’, in relation to any vendor, means the tax charged under section 7 (1) (a) in respect of the supply of goods and services by that vendor.’

<sup>150</sup> Section 7 (1)(a) VAT Act.

## **ESTABLISHING VAT LIABILITY**

### **2.1. A SUPPLY OF GOODS OR SERVICES**

The supply of a good or service is the first requirement for VAT liability to be established. A supply is a performances in terms of a sale, rental agreement, an instalment credit agreement, and all other forms of supply, whether voluntary, compulsory or by operation of law, irrespective of where the supply is effected.<sup>151</sup> The Act also provides for deemed supplies of goods or services, in instances where the character of the supply may not be easily ascertainable.<sup>152</sup>

The subject of the supply must be either a good or a service. The definition of goods under the VAT Act refers to corporeal movable things, fixed property, any real right in such thing or fixed property, and electricity.<sup>153</sup> The definition further states that goods do not include money, rights under a mortgage bond or pledge and revenue stamps. From the definition, it is clear that goods are tangible things, things that can be touched or are associated to things that are fixed, with the special inclusion of electricity. Electricity is included in the definition of goods, as VAT is calculated on the final price of the electricity supplied, including the amount of the environmental levy.<sup>154</sup>

Intangible property, which are incorporeal things that cannot be physically touched, falls under the definition of services in the VAT Act.<sup>155</sup> Services are defined as anything done or to be done, including the granting, assignment, cession or surrender of any right, or the making available of any facility or advantage, but excluding a supply of goods, money or any stamp, form or card contemplated in

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<sup>151</sup> Section 1 VAT Act. provides: 'supply' includes performance in terms of a sale, rental agreement, instalment credit agreement and all other forms of supply, whether voluntary, compulsory or by operation of law, irrespective of where the supply is effected, and any derivative of 'supply' shall be construed accordingly.'

<sup>152</sup> Section 8 and 18(3) VAT Act.

<sup>153</sup> Section 1 VAT Act. provides: 'goods' means corporeal movable things, fixed property and any real right in any such thing or fixed property, but excluding-

- (a) money;
- (b) any right under a mortgage bond or pledge of any such thing or fixed property; and
- (c) any stamp, form or card which has a money value and has been sold or issued by the State for the payment of any tax or duty levied under any Act of Parliament, except when subsequent to its original sale or issue it is disposed of or imported as a collector's piece or investment article.'

<sup>154</sup> Stiglingh op cit note 4 at 1015.

<sup>155</sup> De Swardt & Oberholzer op cit note 89 at 19.

paragraph (c) of the definition of goods.<sup>156</sup> This definition is broadly formulated in such a manner that it acts as a catch-all concept which includes everything that does not constitute goods.<sup>157</sup> Due to this definition, the supply of digital content or electronic services would have been classified as a service in terms of the VAT Act prior to the VAT amendments as they did not fall under the definition of goods. However, due to the broad wording of the definition, De Swardt and Oberholzer state that there was disagreement amongst tax professionals with regard to the classification of digitised content in South Africa as a service, as some specialists considered that it should be classified as a good while others expressed that digitised content could be either a good or service depending on the product.<sup>158</sup> Johnston, in a later study with tax experts, found that all experts agreed that electronically supplied products do not meet the definition of goods under the VAT Act and that they should be classified as a service.<sup>159</sup>

## **2.2. BY A VENDOR**

It is required that the supply must be made by a vendor. A vendor is defined as any person, which includes any public authority, local authority, company, body of persons, the estate of a deceased or insolvent person, trust fund and foreign donor funded project, who is, or is required to be registered under the VAT Act.<sup>160</sup> A supply by a private individual (non-vendor) once in a while of goods or services does not attract VAT.<sup>161</sup> Being registered as a vendor gives rise to duties and rights for the vendor. The duties include ensuring that VAT is collected on taxable supplies, submitting returns and payments on time; issuing tax invoices where required and provide accurate and up to date information to SARS.<sup>162</sup>

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<sup>156</sup> Section 1 VAT Act. provides: 'services' means anything done or to be done, including the granting, assignment, cession or surrender of any right or the making available of any facility or advantage, but excluding a supply of goods, money or any stamp, form or card contemplated in paragraph (c) of the definition of 'goods'.

<sup>157</sup> De Swardt & Oberholzer op cit note 89 at 19.

<sup>158</sup> Ibid.

<sup>159</sup> Johnston op cit note 40 at 76.

<sup>160</sup> Section 1 VAT Act. provides: 'vendor' means any person who is or is required to be registered under this Act: Provided that where the Commissioner has under section 23 or 50A determined the date from which a person is a vendor that person shall be deemed to be a vendor from that date.'

<sup>161</sup> Stiglingh op cit note 141 at 1015.

<sup>162</sup> SARS 'VAT 404: Guide for Vendors' op cit note 140 at 95.

### **2.2.1. Requirement to Register As a Vendor**

Persons are required to register as vendors if they anticipate to or make taxable supplies with a total value that exceeds the stipulated threshold value for a twelve month period, in the month that this occurs.<sup>163</sup> When the threshold has been reached, the person liable to be registered as a vendor is required to take the necessary steps to apply for registration within 21 days.<sup>164</sup> Prior to registering as a vendor, the person that is required to do so must have a fixed place or business, have a bank account and keep proper accounting records.<sup>165</sup> This provision made no distinction between foreign suppliers and local suppliers with regard to registration.<sup>166</sup>

The registration process encompasses submitting the requisite form that is available on the SARS website and the supporting documents. SARS has the legal power to register a person who has become eligible to register but has failed to do so within the stipulated time period.<sup>167</sup> When a registered vendor ceases to make taxable supplies that person may apply to be deregistered as a vendor.<sup>168</sup>

Registration may occur voluntarily, provided that the person is carrying on an enterprise and their taxable supplies exceed R50 000, or has acquired an enterprise as a going concern and it has taxable supplies that exceeded the value of R50 000 during the previous twelve months, or where the person continuously and regularly carries on an activity, by due to the nature of the activity, taxable supplies will be sold for a consideration only after a period of time and the value of such taxable supplies will exceed R50 000 in a twelve month period.<sup>169</sup> Voluntary registration has the same documentary requirements and prerequisite conditions as compulsory registration.

The consequence of voluntarily registering allows for the vendor to claim input tax credits and requires the vendor to levy VAT on all taxable supplies as well. Voluntary registration may be cancelled by the Commissioner if the Commissioner

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<sup>163</sup> Section 23(1) VAT Act.

<sup>164</sup> Section 22 Tax Administration Act 28 of 2011.

<sup>165</sup> Section 23(2) VAT Act.

<sup>166</sup> De Swart & Oberholzer op cit note 89 at 23.

<sup>167</sup> Section 22 Tax Administration Act 28 of 2011.

<sup>168</sup> Section 24(1) VAT Act.

<sup>169</sup> Section 23(3) VAT Act.

is satisfied that the vendor no longer complies with the above registration requirements or has failed to uphold its duties with regard to account records and administrative requirements.<sup>170</sup>

### **2.2.2. Consequences of Registration as a Vendor**

A direct consequence of registration as a vendor is that the vendor will have to account for output tax and will be able to claim input tax, as an agent of SARS. Output tax is levied in terms of section 7 of the Act.<sup>171</sup> Output tax is the VAT amount charged by the vendor. One of the duties of a registered enterprise (vendor) is to charge and collect this amount and account for it to SARS at the end of the tax period.<sup>172</sup> A vendor acts as a collector of VAT where the supply of goods and services occurs within the Republic of South Africa.<sup>173</sup>

A vendor has the right to claim Input tax credits for certain purchases and expenses incurred, wholly or partly, to make taxable supplies.<sup>174</sup> Input tax refers to the VAT charged on expenses incurred by a vendor for supplies for his or her enterprise for the purpose of making taxable supplies.<sup>175</sup> A vendor will be paid or refunded the VAT portion when the input tax accruing to the vendor is deducted from the output tax. The vendor must be in possession of a tax invoice, debit note or credit note from the vendor that supplied the services to claim input tax.<sup>176</sup> Tax invoices must be issued by a registered vendor unless the supply is for a value less than R50.<sup>177</sup> The goods or services supplied must be from a registered vendor for a vendor to claim input tax, except in the case of a supply of second-hand goods.<sup>178</sup>

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<sup>170</sup> Section 24(5) and (6) VAT Act.

<sup>171</sup> Section 7 VAT Act.

<sup>172</sup> Section 27 VAT Act.

<sup>173</sup> Section 7(1)(a) VAT Act.

<sup>174</sup> Section 28 VAT Act.; Stiglingh op cit note 4 at 1015.

<sup>175</sup> Section 1 VAT Act. provides: 'input tax', in relation to a vendor, means- (a) tax charged under section 7 and payable in terms of that section by-

(i) a supplier on the supply of goods or services made by that supplier to the vendor; or

(ii) the vendor on the importation of goods by him; or

(iii) the vendor under the provisions of section 7 (3).'

<sup>176</sup> Section 16(2) VAT Act.

<sup>177</sup> Section 20 VAT Act.

<sup>178</sup> Stiglingh op cit note 141at 1058.



### **2.3. VENDOR IN THE COURSE OF AN ENTERPRISE**

It is required that the supply of goods or services by a vendor must be in the course or furtherance of an enterprise.<sup>179</sup> An enterprise broadly defined is any enterprise or activity, carried on continuously or regularly in South Africa, or partly in South Africa, by any person in the course or furtherance of which goods or services are supplied for a consideration, whether for profit or not.<sup>180</sup> The definition further specifically lists activities that are included and those that are excluded from the definition. The definition of an 'enterprise' and 'the VAT import and export rules operate to determine whether or not consumption of a service is considered to have taken place in South Africa and is consequently subject to South African VAT.'<sup>181</sup>

VAT liability will only be on the supplies that are subject to the registered enterprise and which are supplied for a consideration. A consideration is defined as any payment made or to be made, whether in money or otherwise, or any act or forbearance, whether or not voluntary, in respect of, in response to, or for the inducement of, the supply of any goods or services, whether by that person or by any other person, but does not include any payment made by any person as a donation to any association not for gain.<sup>182</sup>

With regard to foreign suppliers prior to the VAT amendments, it was unclear when they could be said to be conducting an enterprise in South Africa, even if they were making taxable supplies that reached the threshold. The reason was due to the lack of clarity of whether an enterprise in South Africa was established if the foreign supplier merely had its website hosted on a server located

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<sup>179</sup> Section 7(1)(a) VAT Act.

<sup>180</sup> Stiglingh op cit note 4 at 1019; Section 1 VAT Act. provides: 'enterprise' means- (a) in the case of any vendor other than a local authority, any enterprise or activity which is carried on continuously or regularly by any person in the Republic or partly in the Republic and in the course or furtherance of which goods or services are supplied to any other person for a consideration, whether or not for profit, including any enterprise or activity carried on in the form of a commercial, financial, industrial, mining, farming, fishing or professional concern or any other concern of a continuing nature or in the form of an association or club...'

<sup>181</sup> De Swardt & Oberholzer op cit note 89 at 20.

<sup>182</sup> Section 1 VAT Act. provides: 'consideration', in relation to the supply of goods or services to any person, includes any payment made or to be made (including any deposit on any returnable container and tax), whether in money or otherwise, or any act or forbearance, whether or not voluntary, in respect of, in response to, or for the inducement of, the supply of any goods or services, whether by that person or by any other person, but does not include any payment made by any person as a donation to any association not for gain: Provided that a deposit (other than a deposit on a returnable container), whether refundable or not, given in respect of a supply of goods or services shall not be considered as payment made for the supply unless and until the supplier applies the deposit as consideration for the supply or such deposit is forfeited...'

in South Africa or if the foreign supplier had to have a business presence such as a branch with an office operating a call centre in South Africa.<sup>183</sup> De Swardt and Oberholzer noted that a large majority of the tax experts they questioned answered in favour of the latter as an indication of ‘carrying on an enterprise in South Africa.’<sup>184</sup>

### **3. COLLECTION OF VAT FROM IMPORTED GOODS OR SERVICES**

Where goods or services are imported, tax is charged by, collected or accounted for by different persons, either by the recipient of the goods or services, the vendor of the goods or services, or by the port of entry authorities with regard to goods.<sup>185</sup> In situations that a physical good is imported into South Africa the tax payable shall be paid by the person importing the goods to the customs and duties authorities.<sup>186</sup> Where a service is imported into South Africa, the tax payable shall be paid by the recipient of the imported services directly to SARS.<sup>187</sup> This tax collection mechanism is known as the “reverse-charge mechanism”, and it requires that the receiver of the supply of the imported services to personally declare the output tax amount to the tax authorities.<sup>188</sup>

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<sup>183</sup> De Swardt & Oberholzer op cit note 89 at 21

<sup>184</sup> Ibid.

<sup>185</sup> Section 7(1)(b) provides: Subject to the exemptions, exceptions, deductions and adjustments provided for in this Act, there shall be levied and paid for the benefit of the National Revenue Fund a tax, to be known as the value-added tax- (b) on the importation of any goods into the Republic by any person on or after the commencement date ; section 7(2) provides: Except as otherwise provided in this Act, the tax payable in terms of paragraph (a) of subsection (1) shall be paid by the vendor referred to in that paragraph, the tax payable in terms of paragraph (b) of that subsection shall be paid by the person referred to in that paragraph and the tax payable in terms of paragraph (c) of that subsection shall be paid by the recipient of the imported services.

<sup>186</sup> Section 13 (1) VAT Act. provides: ‘For the purposes of this Act goods shall be deemed to be imported into the Republic on the date on which the goods are in terms of the provisions of the Customs and Excise Act deemed to be imported: Provided that-

- (i) goods which are entered for home consumption in terms of the Customs and Excise Act, shall be deemed to have been imported on the date on which they are so entered;
- (ii) where any goods have been imported and entered for storage in a licensed Customs and Excise storage warehouse but have not been entered for home consumption, any supply of those goods before they are entered for home consumption shall be zero -rated for the purposes of this Act;
- (iii) goods imported from or via Botswana, Lesotho, Swaziland or Namibia shall be declared and tax paid on entry into the Republic as prescribed by the Commissioner in Chapter XIIA of the Rules under the Customs and Excise Act.’

<sup>187</sup> Section 7(1)(c) and section 14(1) VAT Act.: ‘Where tax is payable in terms of section 7 (1) (c) in respect of the supply of imported services the recipient shall within 30 days of the date referred to in subsection (2)-

- (a) furnish the Commissioner with a declaration (in such form as the Commissioner may prescribe) containing such information as may be required; and

- (b) calculate the tax payable on the value of the imported services at the rate of tax in force on the date of supply of the imported services and pay such tax to the Commissioner.’

<sup>188</sup> Section 14(1) Act 80 of 1991.

### **3.1. IMPORTATION OF GOODS**

As mentioned above, VAT is levied on the importation of goods into South Africa in terms of section 7(1) (b).<sup>189</sup> The VAT is paid by the importer of the goods, whether or not the importer is a vendor.<sup>190</sup> Goods can be imported through mail or by cargo. When goods are imported by mail, the postal service acts as an agent of the tax authorities and charges VAT before the goods may be released for domestic delivery. Where goods are imported as cargo, the customs and duties agencies at ports of entry into South Africa collect the VAT on the goods.<sup>191</sup>

VAT on the importation of goods is calculated as 14 per cent of the total of customs duty value, 10 per cent customs duty value, and the non-rebated customs duty payable and any import surcharges.<sup>192</sup> In situations where imports from designated countries, such as the BLNS customs union<sup>193</sup>, may have different rules applied to them with regard to custom duties payable, VAT may however be charged.<sup>194</sup> The VAT charged for the custom union goods is equal to 14 per cent of the customs duty values.<sup>195</sup> Section 13(3) of the VAT Act read with Schedule 1 of the Act also provides for the exemption of certain imported goods from VAT.

### **3.2. IMPORTATION OF SERVICES**

Imported services are a supply of services that is made by a supplier who is resident or carries on business outside South Africa to a recipient who is a South African resident to the extent that such services are utilized or consumed in South Africa otherwise than for the purpose of making taxable supplies.<sup>196</sup> Based on this definition, where the supplier is not a registered vendor in South Africa and the supply of services are used to make non-taxable supplies, VAT is payable by the importer. This is based on the fact that the service supplied will be used to make

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<sup>189</sup> VAT Act.

<sup>190</sup> Section 7(2) VAT Act.

<sup>191</sup> Section 13 VAT Act.

<sup>192</sup> Section 13(2)(a) VAT Act.

<sup>193</sup> Botswana, Lesotho, Namibia and Swaziland.

<sup>194</sup> Stiglingh op cit note 4 at 1021.

<sup>195</sup> Section 13(2)(b) VAT Act.

<sup>196</sup> Section 7(1)(c) Value Added Tax Act: 'there shall be levied and paid for the benefit of the National Revenue Fund a tax, to be known as the value-added tax (c) on the supply of any imported services by any person on or after the commencement date, calculated at the rate of 14 per cent on the value of the supply concerned or the importation, as the case may be.'

taxable supplies by the receiver which will later have VAT levied on the supplies the receiver will make to the end-user.

VAT is levied on imported services so as to prevent unfair competition in the domestic market, as imported services in the absence of a VAT charge would offer individuals and businesses lower prices compared to local suppliers.<sup>197</sup> The VAT Act<sup>198</sup> also provides that when an international business with a branch office in South Africa provides services to the branch office in South Africa, this constitutes imported services and VAT will be levied on the supply, so as to prevent the international business from levying services to itself for free.<sup>199</sup>

### **3.2.1. IMPORTED SERVICES UTILISED OR CONSUMED FOR A PURPOSE OTHER THAN FOR THE MAKING OF TAXABLE SUPPLIES.**

Where the supply of the imported service is made to a non-vendor or to a vendor for a purpose other than for making taxable supplies, VAT is payable.<sup>200</sup> In the case of *Metropolitan Life Limited v Commissioner of the South African Revenue Services*<sup>201</sup>, where the taxpayer (appellant) was a life assurance company that made use of the services of overseas consultants, business advisors and computer services, which it contended were zero-rated services for such services had not been physically rendered in South Africa.<sup>202</sup> The taxpayer's made supplies of life insurance which is a financial service in terms of s.2(1)(i) of the VAT Act, and an exempt supply, therefore the services were not used in the making of taxable supplies. The taxpayer relied on the provisions of section 11(2)(k) of the VAT Act which provides for the zero-rating of supplies where services, with the exception of telecommunication services, have been physically rendered outside of South Africa.

The Commissioner (respondent) contended that these supplies were imported services and had assessed the taxpayer for VAT on the grounds that these imported

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<sup>197</sup> Stiglingh op cit note 4 at 1025.

<sup>198</sup> Section 14(4) VAT Act.

<sup>199</sup> Stiglingh op cit note 4 at 1025.

<sup>200</sup> Ibid at 1023.

<sup>201</sup> (2008) 70 SATC 162 (C)

<sup>202</sup> Supra para 4.

services were consumed in South Africa for purposes other than for the making of taxable supplies.

The court a quo held that the provisions of section 11(2)(k) were not applicable to the supply of services made to the taxpayer and that the supply made had been that of imported services and the Commissioner had correctly assessed the taxpayer for the VAT payable.<sup>203</sup> On appeal, the court upheld the ruling of the court a quo and the appeal was dismissed.<sup>204</sup>

In the case of *Commissioner of the South African Revenue Services v De Beers Consolidated Mines Limited*,<sup>205</sup> the taxpayer acquired services from local and overseas professional advisors in relation to a company restructuring transaction with another company. The Commissioner for the South African Revenue Service assessed the services employed by De Beers as imported services and levied VAT on these services in terms of section 7(1)(c) of the VAT Act and disallowed the VAT charged as input tax.<sup>206</sup> The Commissioner's grounds for levying the tax were that the foreign services were unrelated to De Beers' core activities, which was mining and sale of diamonds and the services had not been used to make any of De Beers' businesses better or more valuable. De Beers objected to the assessment on the grounds that 'the services were necessarily attached to and accordingly a concomitant of the company's mining or commercial enterprise as a public company. De Beers took the matter to the Tax Court, where the court ruled in its favour on the grounds that the services provided by the foreign advisors did not

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<sup>203</sup> ITC 1812 (2006) 68 SATC 208 para 38. The court held that section 11 and 12 had to be read with section 14(5)(a) and (b) which provide that the tax chargeable in terms of section 7(1)(c) will not be payable in respect of (a) a supply which is chargeable with tax in terms of section 7(1)(a) at the rate provided for in section 7, or (b) a supply which, if made in the Republic, would be charged with tax at the rate of zero per cent applicable in terms of s. 11 or would be exempt from tax in terms of s. 12. Waglay J further held that s.14 (5)(b), and not s.11 or s.12, governed the zero-rating and exemption of imported services which fell under s.7(1)(c) while not simultaneously falling under s.7(1)(a).

<sup>204</sup> *Metropolitan Life* supra note 201 para 31-33 The court's reasoning was that "tautologous legislation is not unknown but it is preferable to seek to construe a statute so as to make sense of it in its entirety. In my view, section 14(5)(b) can be construed so as to be exhaustive of the cases of imported services which may well otherwise have been charged under section 7(1)(c). This will allow section 11(2) to govern those services rendered by a vendor which would otherwise be taxed in terms of section 7(1)(a). Not only does this conclusion give a coherence to the Act as a whole but it also gives far greater sense to the effect of the 1997 amendment, described in the Explanatory Memorandum as 'textual', than would be the case urged upon this court by appellant, namely an amendment which would have changed the very nature of the relationship between section 14(5)(b) and section 11(2)."

<sup>205</sup> 2012 (5) SA 344 (SCA).

<sup>206</sup> Supra para 4

constitute imported services because they had been used by De Beers for the purpose of making taxable supplies, namely in the course of furthering its enterprise of mining and selling diamonds.<sup>207</sup>

The matter went on appeal to the Supreme Court of Appeals, and the court held in favour of the Commissioner on the grounds that the services supplied were not directed at making any of De Beers' businesses better or more valuable and it had been in the interest of De Beers' departing shareholders and investors, rather than the interest of De Beers itself, that formed the focus of the services from the foreign advisors.<sup>208</sup> Further, it was held that the duty imposed on a public company that is the target of a takeover is too far removed from the advancement of the VAT enterprise to justify characterising services acquired in the discharge of that duty as services acquired for purposes of making taxable supplies.<sup>209</sup> The court reasoned that 'unless one conducts business as an investment company, the investments one holds cannot conceivably be regarded on their own as constituting an enterprise within the meaning of that term in the Act.'<sup>210</sup> Another important aspect was that even though some of the meetings with the foreign advisors were held outside South Africa, it did not detract from the fact that the services were consumed in South Africa.<sup>211</sup>

With regard to imported services it is important that the imported services are 'utilised and consumed in the Republic' and Van Zyl argues that this is not clear as it raises the question whether services are consumed at the place where they are physically rendered, or where the recipient resides or conducts its business.<sup>212</sup> Van Zyl continues to answer this question by identifying that from the case law, *Metropolitan Life*<sup>213</sup> and *De Beers Consolidated*<sup>214</sup> cases, 'it is clear that for intangible services, the phrase 'utilised and consumed in the Republic' entails that

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<sup>207</sup> Supra para 19.

<sup>208</sup> Supra para 26.

<sup>209</sup> Supra para 27.

<sup>210</sup> Supra para 34.

<sup>211</sup> Supra para 37.

<sup>212</sup> Van Zyl 'Determining The Place of Supply or the Place of Use and Consumption of Imported Services for Value Added Tax Purposes: Some Lessons for South Africa from the European Union' (2013) 25 *South African Mercantile Law Journal* 534 to 554 at 535.

<sup>213</sup> Supra note 201.

<sup>214</sup> Supra note 205.

the place of supply is the place where the services were applied and not where they were physically rendered.<sup>215</sup>

### **3.2.2. THE REVERSE-CHARGE MECHANISM/SELF-ASSESSMENT**

#### **MECHANISM**

Therefore, in the case of B2C e-commerce transactions and B2B transactions for purposes other than for taxable supplies, the recipients of electronic services, the imported service, are required to make use of the reverse-charge mechanism. A private consumer or vendor making non-taxable supplies who receives the imported service is required to pay VAT within 30 days from the time of supply and to submit a VAT 215 form in the process.<sup>216</sup> The time of supply is deemed to be the earlier of the issuing of an invoice or the making of any payment by the recipient.<sup>217</sup> It must be noted that a vendor who makes taxable supplies and receives imported services still has to acknowledge receipt of the non-taxed imported service to SARS and later declare it as input tax.<sup>218</sup>

The above mentioned reverse-mechanism is reliant on the honesty of the recipient and difficult to enforce.<sup>219</sup> The risk of non-collection is very high under this mechanism.<sup>220</sup> Due to this shortfall in the reverse-charge mechanism the South African Tax authorities considered it necessary to make VAT amendments to the VAT legislation and provide a registration system for the registration of non-resident suppliers of imported services, specifically electronic services.

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<sup>215</sup> Van Zyl op cit note 212 at 542

<sup>216</sup> Section 14(1) VAT Act.

<sup>217</sup> Section 14(2) VAT Act.

<sup>218</sup> Section 14(1) VAT Act.

<sup>219</sup> Johnston op cit note 40 at 75.

<sup>220</sup> Ibid.

#### **4. CONCLUSION**

The self-assessment method that governed the importation of services, specifically electronic services, into South Africa in B2B and B2C transactions can be argued to be an inefficient way of collecting VAT in B2C transactions, due to how it relies on the private consumer making a declaration to SARS. It is difficult for SARS to monitor such transactions so as to enforce compliance by consumers.<sup>221</sup> The registration method that is sought to be implemented in South Africa is directed at resolving the difficulties that are raised by B2C transactions and will remove the consumer as the taxable person, and replace him or her with a registered vendor, who will then account for the VAT of each transaction to SARS.

The previous law in South Africa in relation to the indirect taxation of digital content and electronic services was insufficient to effectively tax the digital world. The registration method that the new legislation has introduced will be discussed in the next chapter and how e-commerce indirect taxation will be collected in South Africa as of 1 April 2014.

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<sup>221</sup> Ibid at 76.



# CHAPTER 4: THE NEW LEGISLATION GOVERNING THE COLLECTION OF VALUE ADDED TAX FROM NON-RESIDENT SUPPLIERS OF ELECTRONIC SERVICES IN SOUTH AFRICA

## 1. INTRODUCTION

Following the announcement by the previous Finance Minister, Pravin Gordhan, in the 2013 budget speech,<sup>222</sup> legislative efforts commenced to enact new provisions that provided for effective indirect tax collection of VAT liable supplies in the e-commerce economy. The VAT amendments introduced new legislation that provides for the registration of suppliers of electronic services to South African residents or where payment for such services originates from a South African bank, as VAT vendors in South Africa.<sup>223</sup> The effect of this is that the levying of VAT on imported services, specifically electronic services, is now provided for under sections 7(1)(a) and 7(1)(c) of the VAT Act. The changes introduced to the legislation, the process of enactment, policy considerations and effect of these changes will be discussed in this chapter.

## 2. BACKGROUND

### 2.1. THE DRAFT BILL

The first draft of the 2013 Taxation Laws Amendment Bill was published for public comment on 4 July 2013.<sup>224</sup> The Bill's Explanatory Memorandum offers insight into the purpose and motivation for the proposed changes to the VAT legislation.<sup>225</sup> The VAT Act did not contain specific place of supply rules to determine which jurisdiction (South Africa or another country) has taxing rights in respect of e-

<sup>222</sup> Pravin Gordhan '2013 Budget Speech' op cit note 1.

<sup>223</sup> Section 165(1) Amendment Act 31 of 2013.

<sup>224</sup> Taxation Laws Amendment Bill 39 of 2013.

<sup>225</sup> SARS Explanatory Memorandum to the Taxation Laws Amendment Bill 2013 available at: <http://www.sars.gov.za/AllDocs/LegalDoclib/Drafts/LAPD-LPrep-Draft-2013-29%20-%20Draft%20EM%20on%20the%20draft%20TLAB%204%20July%202013.pdf>, accessed 27 June 2014.

commerce transactions,<sup>226</sup> instead the place of supply with regard to electronic services was determined in terms of whether the services were supplied by a registered vendor in the course of the furtherance of an enterprise or whether the services were imported and ‘utilised and consumed in the Republic.’<sup>227</sup> This lack of a specific rule for place of supply means that a foreign supplier’s liability to register for VAT required an interpretative exercise with no clear answers.<sup>228</sup> The Bill<sup>229</sup> therefore introduced a definition of e-commerce and introduced place of supply rules.

The Bill referred to e-commerce and it defined it widely as ‘the supply of any services where the placing of an order or delivery of those services are done electronically.’<sup>230</sup> The definition of ‘enterprise’ was amended to include the supply of electronic services, by a person or business outside of South Africa to a recipient in South Africa.<sup>231</sup> A proxy for the place of supply was introduced which provided that VAT will be levied where the e-commerce services are supplied to a South African resident, or when payment is made from a South African bank account.<sup>232</sup> Other proxies, such as place of performance, customer’s billing address, and customer’s IP address were considered but rejected as these proxies do not offer a clear indication of the location of the customer, and are capable of manipulation.<sup>233</sup>

Where a foreign supplier of electronic services met the above definitions, the foreign person or business became liable to register as a VAT vendor in South Africa, in terms of section 23 of the VAT Act.<sup>234</sup> The first draft Bill did not provide for a registration threshold and applied to all foreign based suppliers of e-commerce,

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<sup>226</sup> De Swardt & Oberholzer op cit note 89 at 20; Van Zyl op cit note 212 at 534.

<sup>227</sup> Section 7(1)(c) VAT Act.

<sup>228</sup> SARS ‘Explanatory Memorandum to the Taxation Laws Amendment Bill 2013’ op cit note 225 at 92.

<sup>229</sup> TLAB 39 of 2013.

<sup>230</sup> S.174(1)(d) TLAB 39 of 2013 provides: ‘Section 1 of the Value-Added Tax Act, 1991 (Act No. 89 of 1991), is hereby amended—by the insertion in subsection (1) after the definition of “dwelling” of the following definition: “electronic services” means the supply of services where the placing of an order or delivery of those services is made electronically.’

<sup>231</sup> S.174(1)(e) TLAB 39 of 2013 provides: ‘by the addition in subsection (1) to paragraph (b) of the definition of “enterprise” after subparagraph (v) of the following subparagraph: “(vi) the supply of electronic services by a person from a place in an export country— (aa) to a recipient that is a resident of the Republic; or (bb) where any payment to that person in respect of such electronic services originates from a bank registered or authorised in terms of the Banks Act, 1990 (Act No. 94 of 1990)’

<sup>232</sup> S.174(1)(e) TLAB 39 of 2013.

<sup>233</sup> SARS ‘Explanatory Memorandum to the Taxation Laws Amendment Bill 2013’ op cit note 225 at 92-93.

<sup>234</sup> Act 89 1991.

therefore any person, even a once-off supplier, became liable to register for VAT. The payment basis was proposed as the suitable accounting basis, so as to alleviate the compliance burden of foreign suppliers. The payment accounting basis provides for the VAT vendor to account for VAT levied on the supply when payment of the supply is made.<sup>235</sup> The 1<sup>st</sup> of January 2014 was proposed as the date when foreign suppliers would become liable.

However, submissions from interested stakeholders argued that this definition was too wide as it encompassed all services supplied via email or the internet and this made the provision ambiguous as it did not distinguish between making an order online and online deliveries.<sup>236</sup> Further it was argued that the definition was not in line with international standards, and had to refer to electronically supplied services.<sup>237</sup> Concern was raised with regard to the lack of distinction between B2B and B2C supplies and the specific reference to non-resident suppliers, instead of a general reference to all suppliers of electronic supplies. Further, requests were submitted for a minimum registration threshold to be applied, similar to that applied to local suppliers.<sup>238</sup> Some interested parties requested that the date for the commencement of the VAT amendments be moved back so as to allow the affected parties to make the necessary arrangements while other parties requested that the date be moved forward.<sup>239</sup>

### **3. THE FINAL VAT AMENDMENTS**

Following the comments from the public, several changes were made to the Bill, particularly, the definition of electronic services was replaced by one that defined electronic services as ‘those electronic services prescribed by the Minister of Finance by regulation in terms of the VAT Act.’<sup>240</sup> A list of specific electronic services would help in ensuring certainty and would be in line with international

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<sup>235</sup> Section 15 Act 89 of 199.1

<sup>236</sup> Watson ‘VAT on Electronic Services and the Fiscus’ op cit note 20.

<sup>237</sup> SARS ‘Response Document to the Taxation Amendment Bill’ at 28, available at <http://www.sars.gov.za/AllDocs/LegalDoclib/RespDocs/LAPD-LPrep-Resp-2013-02%20-%20Draft%20Response%20to%20SCoF%20on%202013%20TLAB%20and%20TALAB%2011%20Sept%202013.pdf>, accessed 27 June 2014.

<sup>238</sup> Ibid.

<sup>239</sup> Ibid.

<sup>240</sup> S.165(1)(d) Amendment Act 31 of 2013.

standards.<sup>241</sup> The regulations were not published simultaneously with the second draft Bill, leaving much speculation as to which services would be included as electronic services.

As mentioned above, the VAT amendments inserted proxies to the definition of ‘enterprise’ which will make a foreign supplier an enterprise if it makes a supply of electronic services to a recipient that is a resident of the Republic; or where one or more payments to that person originates from a bank registered in South Africa.<sup>242</sup> A ‘resident’ for VAT purposes is a person who resides in South Africa for a specific number of days during a five-year period or is a business with its place of effective management in South Africa.<sup>243</sup> Van Zyl states that these proxies are useful and will offer assistance for the determination of the place of supply for electronic services.<sup>244</sup> However, these proxies do not apply to all other cases of imported services.

The request for a minimum threshold was partially accepted, and the Bill placed an obligation to register on foreign suppliers if they make supplies of electronic services in excess of R50 000 in a 12 month period to South African customers.<sup>245</sup> A lower threshold than this was stated to be impractical to addressing the problem of non-compliance in electronic transactions and the aim of levelling the playing field between local and international suppliers of electronic services. A distinction between B2B and B2C supplies was refused on the grounds that this would increase the compliance burden for international suppliers and this could result in fraudulent behaviour where private individuals posed as business customers to avoid the levying of tax. With regard to the implementation date, a later date was accepted as appropriate, so as allow for the legislative process to be followed and for affected parties to address any necessary updates of changes to their systems.<sup>246</sup>

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<sup>241</sup> SARS ‘Response Document to the TLAB’ op cit note 237 at 28.

<sup>242</sup> Section 165(1) TLAB 2013.

<sup>243</sup> Section 1 Income Tax Act 58 of 1962.

<sup>244</sup> Van Zyl op cit note 212 at 546.

<sup>245</sup> Section 23(1A) VAT Act.

<sup>246</sup> SARS ‘Response Document to TLAB 2013’ op cit note 237 at 28.

#### 4. THE DRAFT REGULATIONS

The Minister of Finance published the first draft of regulations that listed services that are considered to be electronic services in terms of the VAT amendments on 30 January 2014.<sup>247</sup> Several definitions in the draft regulations referred to definitions as provided by the Electronic Communications and Transactions Act.<sup>248</sup> This initial list of electronic services included more categories of electronic services than those listed in the final regulations. The electronic services initially listed were educational services; games and games of chance; internet based auction services; miscellaneous services; subscription services; information system; information system services, maintenance services.<sup>249</sup> The proposed miscellaneous services included e-books, films, images, music and software.<sup>250</sup> These terms will be explained and expanded upon below.

Educational services referred to by the regulations are any supply of distance teaching programme; educational webcast; internet based course; and webinar.<sup>251</sup>

Games and games of chance are supplies of any electronic internet game, or multiplayer role playing game; interactive games based on chance and/or skill of the player; and electronic online wagering and betting on races or the occurrence of an event.<sup>252</sup>

Internet based auction services are supplies of an internet-based auction services facilities.<sup>253</sup> For example, eBay, BidorBuy.

Information Systems services are the supply of any information system services. Information system is defined as a system for generating, sending, receiving, storing, displaying or otherwise processing data messages and includes the internet.<sup>254</sup> Information system services includes the provision of connections; the operations of facilities for information systems; the provision of access to information systems; the transmission of routing of data messages between and among points of specified by a

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<sup>247</sup> 'Draft Electronic Services Regulations' of 30 January 2014, available at <http://www.sars.gov.za/AllDocs/LegalDoclib/Drafts/LAPD-LPrep-Draft-2014-02%20-%20Draft%20Regulations%20Electronic%20Communication%20Services%20VAT.pdf>, accessed 12 February 2014.

<sup>248</sup> Ibid.

<sup>249</sup> Ibid.

<sup>250</sup> Ibid.

<sup>251</sup> Ibid.

<sup>252</sup> Ibid.

<sup>253</sup> Ibid.

<sup>254</sup> Section 1 Electronic Communications and Transactions Act 25 of 2002.

user; and the processing and storage of data at the individual request of the recipient of the services.<sup>255</sup>

Miscellaneous services comprise of the supply of a digitised content of any book or electronic publication in the form of e-books; audio visual content which is a set of moving visual images or other visual signals, whether with or without accompanying sounds, where the visual images are such that sequences of them are seen as moving pictures' and the right to view such visual audio content; still images are a supply of desktop themes, photographic image, pictorial image, or screensaver, or the right to view these; and music content which includes audio clip, broadcast not simultaneously broadcast over conventional radio network in the Republic, jingle, live streaming performance, ringtone, song, or sound effect, and any right to listen to music content; and lastly, subscription services which include online subscriptions to any journal, magazine, newspaper, game, internet-based auction service, periodical, publication, social networking service, webcast, webinar, web site, web applications, or web series.<sup>256</sup>

## 5. **THE FINAL REGULATIONS**

The final regulations were published on the 28<sup>th</sup> of March 2014.<sup>257</sup> Changes were made to the list of electronic services and the final list includes education services; games and games of chance; films, music, images, miscellaneous services; and subscription services.<sup>258</sup> The reduced scope of the final regulations, which excludes information system; information system services; maintenance services; and software from the list of miscellaneous services, is a welcomed alteration.<sup>259</sup> The National Treasury cited that the reason for this exclusion is due to a policy decision not to include B2B supplies, and focus primarily on B2C supplies.<sup>260</sup>

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<sup>255</sup> 'Draft Electronic Services Regulations' of 30 January 2014 op cit note 247.

<sup>256</sup> Ibid.

<sup>257</sup> Electronic Services Regulations GN221 GG37489.

<sup>258</sup> Electronic Services Regulations GN221 GG37489.

<sup>259</sup> Moss-Holdstock 'The Impact of E-Services Under the New Regulations', available at: <https://saoug.files.wordpress.com/2014/06/e-services-and-educational-institutions-carmen.pdf>, accessed 4 July 2014; Watson 'VAT on Electronic Services and the Fiscus' *TaxTalk* 15, available at: [http://reference.sabinet.co.za.ezproxy.uct.ac.za/webx/access/electronic\\_journals/taxtalk/taxtalk\\_n45\\_a9.pdf](http://reference.sabinet.co.za.ezproxy.uct.ac.za/webx/access/electronic_journals/taxtalk/taxtalk_n45_a9.pdf), accessed 16 July 2014.

<sup>260</sup> National Treasury 'Media Statement Electronic Services Regulations: Request for Public Comments' op cit note 11.

A foreign supplier will be liable to register as a VAT vendor in instances where it finds its supplies of any of the above listed electronic services exceeding the threshold, even where the bulk of its activities do not constitute electronic services.<sup>261</sup> It must be noted that a consumer that receives a supply of electronic services which are not listed in the regulations and which are supplied to a consumer who would not use utilise the services in order to make taxable supplies and would not be entitled to claim the VAT as input tax if VAT would have been charged, is liable to account for the VAT to the tax authorities.<sup>262</sup>

## **6. THE REGISTRATION PROCESS FOR FOREIGN ELECTRONIC SERVICES SUPPLIERS**

The registration process has been simplified and SARS has issued a VAT Registration Guide for Foreign Suppliers of Electronic Services, currently available on its website.<sup>263</sup> SARS has also undertaken updates to its systems so as to accommodate the increase in registrations, returns and payments that accompany this new dispensation. An application for registration can be made electronically, through the submission of a VAT 101 registration form with the accompanying required documentation.<sup>264</sup> The processing of and finalisation of the application by SARS should be executed within 72 hours. Certain registration requirements have been excluded with regard to foreign suppliers, such as the opening of a South African bank account and having a local VAT representative in South Africa. The submission of VAT returns and VAT payments can be done electronically.<sup>265</sup>

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<sup>261</sup> Moss-Holdstock 'The Impact of E-Services under the New Regulations' op cit note 59.

<sup>262</sup> Section 14 VAT Act.

<sup>263</sup> SARS 'VAT Registration Guide for Foreign Suppliers of Electronic Services', available at: <http://www.sars.gov.za/AllDocs/OpsDocs/Guides/VAT-REG-01-G02%20-%20VAT%20Registration%20Guide%20for%20Foreign%20Suppliers%20of%20Electronic%20Services%20-%20External%20Guide.pdf>, accessed 30 May 2014.

<sup>264</sup> Ibid.

<sup>265</sup> Ibid.

## 7. **ENFORCEMENT**

The primary concern is whether SARS will be able to efficiently and effectively monitor the foreign suppliers so as to make them register or comply with the rules with regard to accounting for VAT. Also, when there is failure to comply it is unclear how SARS will enforce these new rules, particularly due to the location of foreign supplier in other countries. In terms of the VAT legislation a person who is liable to register as a vendor and fails to do so is guilty of an offence and is liable to a fine or imprisonment for a period not exceeding two years.<sup>266</sup> Also a person may be subject to penalties on output tax not accounted for from the time such person became liable to register.<sup>267</sup>

Louw and Botha<sup>268</sup>, two practising attorneys, are of the opinion that current or future international treaties may need to be relied upon by SARS to ensure enforcement of the new legislation. This opinion is premised on the recent case of *Commissioner of South African Revenue Services v Krok*<sup>269</sup> in which SARS assisted the Australian tax authorities to obtain a preservation order against an Australian taxpayer that had assets in South Africa. The taxpayer had been assessed for tax in Australia. This assistance by SARS to the tax authorities was facilitated by an international treaty between South Africa and Australia, which provides for mutual assistance in respect of enforcing tax debts.

## 8. **CONCLUSION**

The above VAT amendments are consistent with the guidelines and recommendations of the OECD. Digital content has been classified as a service under the definition as ‘electronic services’. The place of supply has been provided for as the place where the recipient is located and consumes the electronic services. A simplified registration system has been introduced for foreign suppliers of electronic services. The deviation from the OECD lies in how the VAT amendments do not distinguish between B2B and B2C transactions when it comes to registration.

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<sup>266</sup> Section 58 VAT Act.

<sup>267</sup> Section 60 VAT Act.

<sup>268</sup> Louw & Botha ‘Value Added Tax on Electronic Services Supplied by Persons Outside South Africa’ available at <http://www.thesait.org.za/news/168149/Value-added-Tax-on-electronic-services-supplied-by-persons-outside-South-Africa.htm>, accessed 29 June 2014.

<sup>269</sup> *Commissioner of South African Revenue Services v Krok* (HC 1319/2013 NG).



The South African tax authorities have involved interested persons and businesses in the enactment process of the provisions governing electronic services and foreign supplier registration. A compromise and balance between the interests of the tax authorities and those of limiting the compliance burden for affected parties is evident in the legislative process. The VAT amendments and the Regulations are clear and unambiguous, offering clarity to the VAT liability of foreign suppliers of electronic services and an uncomplicated new dispensation in the South African VAT system. Only time can tell how well these provisions will work in practice.<sup>270</sup>

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<sup>270</sup> Watson 'VAT on Electronic Services and the Fiscus' op cit note 20.

# CHAPTER 5: EUROPEAN UNION VALUE ADDED TAX SYSTEM

## 1. INTRODUCTION

It was stated by the South African Minister of Finance that the proposal to require the registration of non-resident suppliers of digital products in South Africa was spurred by the efforts that have been made by the European Union, and the South African tax authorities sought to follow in the European Union's footsteps.<sup>271</sup> An analysis of the European Union's indirect tax system is necessary in light of this statement. The discussion in this chapter will make a comparative analysis between the new e-commerce dispensation in South Africa and that of the European Union VAT system. A brief background of the old VAT system, the transitional system and the current VAT system will be highlighted.

## 2. THE EUROPEAN UNION: A BACKGROUND

The European Union is comprised of 28 member countries<sup>272</sup>, and the executive body of the Union is the European Commission (hereafter referred to as the Commission).<sup>273</sup> The Commission has 28 Commissioners in the College of Commissioner that are representative of each of the member states.<sup>274</sup> The headquarters of the Commission are located in Brussels, Belgium. The role of the Commission include representing the interests of the European Union internationally, assuming the responsibility of proposing legislation to Parliament and Council; managing and implementing European Union policies and setting the budget; and enforcing European Union legislation and treaties against member states.<sup>275</sup>

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<sup>271</sup> Pravin Gordhan '2013 Budget Speech' op cit note 1.

<sup>272</sup> The European Union includes Austria, Belgium, Bulgaria, Croatia, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxemburg, Malta, Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden and the United Kingdom.

<sup>273</sup> European Commission 'About the European Commission', available at <http://ec.europa.eu/about/>, accessed on 3 July 2013.

<sup>274</sup> Ibid.

<sup>275</sup> Ibid.

### 3. **THE EUROPEAN UNION'S VALUE ADDED TAX SYSTEM**

The European Union uses a Value Added Tax indirect tax system.<sup>276</sup> Similar to the South African VAT system, the European Union system distinguishes between the supply of goods and services and has different rules with regards to the place of taxation when the supply is of a good or a service.<sup>277</sup> The VAT system makes use of both the origin and the destination principles<sup>278</sup>, and these different rules will be discussed below. The legislation that provides for the VAT system of the European Union is the Sixth Directive of 1977<sup>279</sup> and the VAT amendments that have been further legislated.<sup>280</sup> This discussion of the European Union VAT system will be focused on the provisions that apply to e-commerce and the digitally supplied products

#### 3.1. **THE PREVIOUS VAT SYSTEM OF THE EUROPEAN UNION**

The Sixth Directive of 1977<sup>281</sup> is one of the Directives that have been implemented in the European Union under Article 99 of the Rome Treaty of 1957 in an attempt to harmonise the VAT collection systems of the European Union member states.<sup>282</sup> Under the Sixth Directive a supply of goods is defined as the transfer of the right to dispose of tangible property as the owner.<sup>283</sup> A supply of services is defined as to include any transaction which does not constitute a supply of goods within the meaning of Article 5.<sup>284</sup> Services, therefore refer to the transfer of intangible property.

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<sup>276</sup> European Union 'How VAT Works', available at

[http://ec.europa.eu/taxation\\_customs/taxation/vat/how\\_vat\\_works/](http://ec.europa.eu/taxation_customs/taxation/vat/how_vat_works/), accessed 3 July 2013.

<sup>277</sup> DM Parrilli 'European VAT and Electronically Supplied Services', available at

[http://pubfin.nccu.edu.tw/faculty/shinemay/European\\_VAT\\_and\\_Electronically\\_Supplied\\_Services\\_DPTI\\_010908%20\(1\).pdf](http://pubfin.nccu.edu.tw/faculty/shinemay/European_VAT_and_Electronically_Supplied_Services_DPTI_010908%20(1).pdf), accessed on 11 July 2013.

<sup>278</sup> European Union 'How VAT Works' op cit note 276.

<sup>279</sup> Council Directive 1977/388/EC of May 1977.

<sup>280</sup> Council Directive 2002/38/EC of May 2002; Council Directive 2006/112/EC of November 2006; Council Directive 2008/8/EC of February 2008.

<sup>281</sup> Council Directive of 2002.

<sup>282</sup> T Fawkes 'The Proposed European Union VAT on Electronically Transmitted Services: Enforcement and Compliance Issues' (2001) 22 *Northwestern Journal of International Law & Business* 47 at 49.

<sup>283</sup> Article 5 Sixth Council Directive of 1977.

<sup>284</sup> Article 6(1) Sixth Council Directive of 1977.

### 3.1.1. **THE TRANSITIONAL SYSTEM:**

The original Sixth Directive was amended in 1993 and a transitional system was created which was aimed at creating a ‘single market’ as envisioned by the European Union member states at the inception of the European Union<sup>285</sup> The transitional system retained the destination system but established an administrative system at the consumptive level and required producers of goods and providers of services to collect the VAT on behalf of the member state in which they were domiciled, thus making VAT an indirect consumption tax on the final price of supplies and goods sold in the European Union<sup>286</sup>

Under this system, it followed that when a good was supplied from one European Union member state to another European Union member state, the VAT was assessed and collected in the member state that the goods had originated from, except for when the recipient of the good was a VAT registered taxable person, in which case the recipient of the good was required to self-assess the tax under the reverse charge mechanism and pay it to the member state that he was domiciled.<sup>287</sup> This amendment was made so as to remove VAT collection at the border for intra-European Union transactions and to allow for goods to move more freely between member states of the European Union<sup>288</sup> Further, this system provided that when goods were supplied by a non-European Union supplier, since the place of origin was not the European Union, no VAT liability was attributable to the supplier, however, the goods would be subject to import VAT and VAT would be collected by Customs at the port of entry before the customer received the goods.<sup>289</sup>

The original Sixth Directive generally provided that the supply of services would take place in the state in which the supplier has established his business, has a fixed establishment from which to service his supply, or has a permanent address where he usually reside<sup>290</sup>, subject to the exception of when cultural, artistic, sporting, scientific, educational and entertainment services were physically carried

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<sup>285</sup> Council Directive 1991/680/EEC; Council Directive 1992/111/EC.

<sup>286</sup> Fawkes op cit note 282 at 50.

<sup>287</sup> Ibid; R Westin op cit note 42 at 131-134.

<sup>288</sup> Westin op cit note 42 at 127.

<sup>289</sup> Ibid at 133; Fawkes op cit note 42 at 51.

<sup>290</sup> Article 9(1) Council Directive of 1977.

out; and with regard to professional services.<sup>291</sup> In these exceptional cases, if the service was provided to a consumer outside the jurisdiction of the supplier, the applicable place of supply rule was the place where the customer has established his business or has a fixed establishment to which the service is supplied or the place where he has his permanent address or usually resides.<sup>292</sup>

The Transitional System had not amended the rules with regard to services and the original place of supply rules stated above were applicable. In practice, the place of supply rules unintentionally provided for a distinction for services supplied to a VAT registered taxable person (B2B transactions) and for services supplied to a non-taxable consumer (B2C transactions). In instances of a supply of services to a VAT registered taxable person (usually a business) to another VAT registered taxable business, the supplier of the service would be exempt from VAT, and the burden of the collection and payment of VAT would shift to the recipient of the service under the reverse charge mechanism.<sup>293</sup> The same rule applied to instances where the supply was made from a non-European Union business.<sup>294</sup>

However, when these rules were applied to non-taxable consumers, the provisions of Article 9(1) applied exclusively, to the exclusion of the exceptions, and this had the effect of identifying the place of supply as the place of the supplier. This was not problematic when it was applied to e-commerce B2C transactions of suppliers resident in the European Union. The place of supply rules affected e-commerce B2C transactions where the supply was made by a non-European Union supplier to a European Union consumer, and resulted in no VAT being collected for the services supplied. In this respect the Sixth Directive had failed to include provisions for taxation of e-commerce services despite the fact that consumption of digital products took place in the European Union<sup>295</sup>

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<sup>291</sup> Article 9(2) (c) and Article 9(2) (e) Council Directive of 1977.

<sup>292</sup> Article 9(2) (e) Council Directive of 1977.

<sup>293</sup> Fawkes op cit note 42 at 51; Van der Merwe op cit note 56 at 577.

<sup>294</sup> Van der Merwe op cit note 56 at 577.

<sup>295</sup> Ibid at 577; Westin op cit note 42 at 136.

### **3.1.2. THE PROBLEMS WITH THE OLD VAT SYSTEM**

The non-taxation of e-commerce services supplied by non-European Union businesses resulted in a situation where these businesses had a competitive advantage over their European Union counterparts. The European Union businesses that supplied e-commerce services to both European Union consumers and non-European Union consumers were required to charge VAT on both these supplies and their prices were comparatively higher than those of non-European Union suppliers who did not have to include VAT in their product prices.<sup>296</sup> The supplies of e-commerce services were completely untaxed if the non-European Union supplier was not resident in a country that also applied an origin based mechanism in its indirect tax system.<sup>297</sup> It cannot be ignored that another motivation that accompanied the need to tax B2C e-commerce transaction was the deductible inference that the continued non-taxation of these services would affect the tax revenues of the member states in the European Union.

## **3.2. THE CURRENT VAT SYSTEM OF THE EUROPEAN UNION**

The European Commission responded to these issues by amending the Sixth Directive by specifically including digitally supplied products as a taxable service and by amending the place of supply rules that applied to these transactions.

### **3.2.1. THE COUNCIL DIRECTIVE OF 2002**

On the 1<sup>st</sup> of July 2003 the European Council Directive of 2002<sup>298</sup> and accompanying regulations<sup>299</sup> came into force, subject to the condition that they would remain in force for three years and would either be extended thereafter or revised. The main changes that were made were those relating to the characterization of digital products as a service and the place of supply of these digital products. The European Union described digital products as electronically supplied services (e.s.s.) and it refrained from defining what e.s.s. was, but included

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<sup>296</sup> Ibid at 578.

<sup>297</sup> Ibid.

<sup>298</sup> Council Directive of 2002.

<sup>299</sup> Council Regulation No 792/2002.

an indicative list of what it comprised of in an annexure.<sup>300</sup> The reason for not defining what e.s.s. is was because of the disadvantage of such a method as it creates problems in defining each type of service on the list, runs the risk of quickly becoming outdated and creates a fence around which avoidance and tax planning can occur.<sup>301</sup> The defining aids that are provided by the Directive are sufficient to include digital products in general and it successfully classifies them as a service for VAT purposes.

The European Union definition of digital content is in accord with the recommendation of the OECD and it bears some similarity to that introduced by the Tax Laws Amendment Act<sup>302</sup> in that it offers a list of the specified electronic supplied services in regulations. The European Union list has some electronic services which are not in the final electronic services regulations of South Africa, although they were in the first draft, namely those pertaining to, websites and software.

The Directive amended the previous deemed supply rules of Article 9(2)(e) and included e.s.s. supplied from an European Union supplier to a non-European Union consumer or to a European Union business customer as supplies of services deemed to be in the location of the consumer or business.<sup>303</sup> Further, the amendment provided that the place of the consumer is where the consumer is established, has a permanent address, or usually resides.<sup>304</sup> The effect of these VAT amendments was to make the European Union member states the places of supply and this meant that supplies made to non-European Union consumers by the European Union business suppliers of e.s.s. would not be subject to VAT and were thus exempt.<sup>305</sup> The secondary effect of these VAT amendments was that the new place of supply rules required that non-European Union business suppliers of e.s.s. had to register in each

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<sup>300</sup> DM Parrilli 'European VAT and Electronically Supplied Services' op cit note 277; Annex to EC Council Directive of 2002 lists electronic supplied services as

- (1) website supply, web-hosting, distance maintenance of programmes and equipment;
- (2) supply of software and updating of;
- (3) supply of images, text and information, and making databases available;
- (4) supply of music, games, films and games of chance and gambling games, and of political, cultural, artistic, sporting, scientific and entertainment broadcasts and events;
- (5) supply of distance teaching.

<sup>301</sup> Van der Merwe op cit note 56 at 580.

<sup>302</sup> Act 31 of 2013.

<sup>303</sup> Article 9(2) (e) Council Directive of 2002.

<sup>304</sup> Article 9(2) (f) Council Directive of 2002.

<sup>305</sup> Van der Merwe op cit note 56 at 582.

and every member state of the European Union that it supplied e.s.s. to.<sup>306</sup> Van Zyl states that generally, the specific place-of-supply proxies were developed to reflect the actual place of consumption accurately, without requiring an investigation of the actual place where the supplies were utilised and consumed.<sup>307</sup> To limit the burden on the online supplier a special scheme (One-Stop-Scheme) for registration was provided for.<sup>308</sup>

The amendment provided for the requirement that all non-European Union suppliers of e.s.s. must register with at least one European Union member state as a VAT registered taxable person.<sup>309</sup> Non-European Union suppliers were also welcome to register in more than one European Union member state. Registration with one member state of the European Union allowed for the discharge of VAT obligations as other European Union suppliers. The registration results in the allocation of a VAT number in the Member State of Identification<sup>310</sup> and all VAT obligations, which include self-assessing and collecting the VAT rate payable for each transaction with European Union consumers from each European Union member state, and paying these amounts to the tax authorities of the Member State of Identification.<sup>311</sup> The tax authorities of the Member State of Identification would then allocate the VAT to the Member States of consumption, which is the place where the consumer of supplied e.s.s. is located and has jurisdiction to audit the foreign supplier.<sup>312</sup> Lamensch states that the one-stop-scheme offers the advantage to online suppliers in that it allows it to register once in the European Union, have one VAT number, and centralises filing obligations in one jurisdiction.<sup>313</sup>

The above registration system only applies where the supply of e.s.s. was being made to a private consumer who is not registered as a taxable VAT person.<sup>314</sup> The amendment did not alter the VAT consequences of supplying to a VAT registered business person in the European Union. The same rules of self-

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<sup>306</sup> Article 26c Council Directive of 2002.

<sup>307</sup> Van Zyl op cit note 212 at 550.

<sup>308</sup> Preamble to Council Directive 2002/38/EC.

<sup>309</sup> Article 26c Council Directive of 2002.

<sup>310</sup> Article 26c Council Directive of 2002.

<sup>311</sup> Article 26c (5) Council Directive of 2002.

<sup>312</sup> Article 26c Council Directive of 2002.

<sup>313</sup> Lamensch 'Are the Reverse Charging and the One-Stop-Scheme Efficient Ways for Collecting VAT on Digital Supplies' (2012) vol 1(1) *World Journal of VAT/GST Law*.

<sup>314</sup> Article 26c Council Directive 2002/38/EC of May 2002.



assessment and the reverse charge mechanism apply.<sup>315</sup> This is different to the VAT amendments made in South Africa, as the Tax Law Amendment Bill does not distinguish between B2B and B2C supplies by a foreign supplier of electronic services. It can be argued that this reduces the burden on the supplier as it does not have to take steps to identify if the customer is either. Further, the European Union does not have a registration threshold minimum amount value of supplies for a supplier to become liable to register.<sup>316</sup>

The status of the person purchasing the digital products and their location are the determining factors of whether non-European Union suppliers have VAT obligations and whether or what rate of VAT has to be collected by the non-European Union suppliers. Infrastructural support was necessary for the correct determination of status and location and the Commission introduced an online VAT registration validation system called the VAT Information Exchange System (VIES).<sup>317</sup> The VIES can be used by members of the public to ascertain and verify the VAT status of businesses and consumers in all European Union member states.

### **3.2.2. SUBSEQUENT COUNCIL DIRECTIVES**

Further VAT amendments were passed by the Commission with regard to the provisions governing e-commerce transactions in the European Union. The 2006 Council Directives<sup>318</sup> addressed the extension of the application of the VAT amendments implemented by the Council Directive of 2002. The Council Directive of 2008<sup>319</sup> provides for the permanent application of the VAT amendments introduced by the 2002 Directive and further provides that as from 2015, intra-European Union B2C suppliers of services will also be required to charge VAT at the rates of each member state that their consumers are located in the European Union. The consequences of these VAT amendments are that the reverse charge mechanism is reserved for B2B e-commerce transactions; and registration of non-

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<sup>315</sup> Van der Merwe op cit note 56 at 580.

<sup>316</sup> Council Directive of 2002.

<sup>317</sup> Van der Merwe op cit note 56 at 581.

<sup>318</sup> Council Directive of 2006/58/EC of June 2006 and Council Directive 2006/138/EC of December 2006.

<sup>319</sup> Council Directive 2008/8/EC of February 2008.

resident suppliers as the method of collecting VAT for B2C e-commerce transactions.

#### **4. PRACTICAL IMPLICATIONS OF THE AMENDED DIRECTIVE**

The provisions of the Directive of 2002 were met with much criticism.<sup>320</sup> The criticism was not unwarranted as the Directive's measures did not completely eradicate the problems that are associated with e-commerce transactions, both B2B and B2C. Further VAT amendments have been implemented but the VAT system relating to e-commerce in the European Union still has unresolved issues.

Lamensch<sup>321</sup> highlights the problems that accompany the use of reverse charging in B2B transactions and the use of the 'one-stop-scheme' (registration of non-resident suppliers) for B2C transactions. The problems that are associated with reverse charging include potential interruption of the VAT chain, increased compliance burden and costs, and the need to determine the status and location of their customer.<sup>322</sup> The one-stop-shop method also has the problem of a high compliance burden, the need to determine the status and location of the customer and enforcement by the tax authorities.<sup>323</sup> These problems will be discussed further below.

##### **4.1. IDENTIFICATION OF STATUS AND LOCATION OF THE CUSTOMER**

The status of a customer is important because it determines the applicable VAT collection method. Determining whether the customer is a business or a private consumer under the current system can be done by requiring that the customer furnish sufficient information to the supplier to prove their status. The submission of a VAT registration number during the transaction would allow the supplier to determine whether it should not charge the VAT and shift the VAT liability to the

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<sup>320</sup> J Ivinston 'Why the EU VAT and E-Commerce Directive Does Not Work' (2003) 14 *International Tax Review* 27; S Basu 'European VAT on Digital Sales' (2002) 3 *The Journal of Information, Law and Technology* 1-126.

<sup>321</sup> Lamensch op cit note 313 at 1.

<sup>322</sup> Ibid at 4-6.

<sup>323</sup> Ibid at 7-9.

customer for the reverse charge mechanism to apply.<sup>324</sup> However, the VAT registration number that is supplied should be verified so that the supplier is certain as to the status. As mentioned above, the VIES was put in place to facilitate this process. However, despite the presence of this verification system, the identification of whether a customer is a business or a private consumer, may prove to be difficult as verification may not be made timeously for direct e-commerce transactions that occur almost instantly over the internet.<sup>325</sup>

Knowledge of the location of the customer is important for both VAT collection systems, but it is more important for B2C transactions as suppliers are required to pay VAT to each member state that their customers are located in. The determination of location is mainly dependant on the information that the consumer provides to the supplier and there are very few ways in which the supplier is able to verify this information. Consumers may be driven by the desire to remain anonymous, or to save on VAT costs, and may refuse to disclose this required information or provide the supplier with false information.<sup>326</sup> In essence the supplier has to accept the information provided by the consumer in good faith and the European Union system provides that a supplier may rely on any other proof that demonstrates that the customer is a taxable person or a non-taxable legal person by carrying out a reasonable level of verification of the information provided through normal commercial security measures relating to identity or payment checks.<sup>327</sup> However, payment information from banks or credit card companies may not provide sufficient information to identify the consumer or the consumer's location<sup>328</sup>, and the supplier may not have access to the payment details if payment is effected through intermediaries such as PayPal.<sup>329</sup>

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<sup>324</sup> Ibid at 4.

<sup>325</sup> Ibid at 8.

<sup>326</sup> Van der Merwe op cit note 56 at 584; Basu op cit note 320.

<sup>327</sup> Article 18 Council Regulation 282/2011 of March 2011.

<sup>328</sup> Kogels 'VAT @ e-commerce' (1999) 8 *European Commission Tax Review* 117-122 at 121.

<sup>329</sup> Lamensch op cit note 43 at 8.

#### 4.2. **ONE-STOP-SHOP MECHANISM COMPLIANCE BURDEN**

The new registration system that was implemented is criticised for how it imposes a high compliance burden on the non-European Union supplier by requiring the supplier to take steps to verify the status and location of their customers.<sup>330</sup> This was argued to result in a competitive disadvantage for non-European Union suppliers because their European Union counterparts charge a single rate of VAT (VAT rate applicable in the member state that it is established) to all their customers and were not burdened with the responsibility of determining the status and location of their customers in the European Union<sup>331</sup> Due to the one-stop-shop scheme a non-European Union based suppliers not only has to comply with the requirements of the Member State of Identification but also has to comply with the requirements of all the Member States of Consumption.<sup>332</sup>

Another aspect of the one-stop-shop scheme that negatively affects non-European Union based suppliers is that of the requirements to submit quarterly VAT returns, whether or not e.s.s. was supplied or not during that period.<sup>333</sup> The non-European Union based suppliers are required to electronically submit a VAT return to the Member State of Identification showing the total value of e.s.s. supplied; the total value of VAT charged; the applicable VAT rate; and the total VAT due for each Member State of Consumption.<sup>334</sup> The non-European Union based supplier must pay the VAT when submitting the VAT return.<sup>335</sup> They are not allowed to deduct input VAT from output VAT as European Union based suppliers but may only claim any input credit from each Member State of Consumption through the Thirteenth Directive Reclaim, which is complex and time consuming.<sup>336</sup> This also negatively impacts the cash flow of these non-European Union based suppliers.<sup>337</sup> The costs of complying with the requirements of the one-stop-shop scheme may prove to be more than the profits that can be made from each transaction for non-European Union based suppliers.

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<sup>330</sup> Van der Merwe op cite note 56 at 586; Lamensch op cit note 313 at 5-6.

<sup>331</sup> Van der Merwe op cit note 56 at 583.

<sup>332</sup> Ibid.

<sup>333</sup> Article 364 Council Directive of 2008.

<sup>334</sup> Article 365 Council Directive of 2008.

<sup>335</sup> Article 367 Council Directive of 2008.

<sup>336</sup> Article 368 VAT Directive ; Van Der Merwe (2004) 585

<sup>337</sup> Lamensch op cit note 313 at 7.

In an effort to remedy the disparities between European Union based and non-European Union based supplier, the latest European Union VAT Directive proposes to apply the same rules with regard to the place of supply of e.s.s. for European Union based suppliers, by deeming the place of supply to be the member state of the consumer.<sup>338</sup> As of 1 January 2015, all supplies of e.s.s. will be taxed at the rate of each member state in which the consumer, whether the supply is from a European Union based or non-European Union based supplier. However, the provisions will be applicable to suppliers that are not established in the Member State of Consumption.<sup>339</sup> The Commission, in essence, ‘instead of creating legal tools to reduce or abolish the difficulties linked to the implementation of the ‘special scheme’ for the non-European Union firms... decided to extend them ... to European Union established companies.’<sup>340</sup>

#### **4.3. ENFORCEABILITY AND COMPLIANCE**

For any system to be successful it must be capable of enforcement. However, ‘enforceability is the Achilles heel of the new VAT system.’<sup>341</sup> The one-stop-shop scheme has resulted in the registration of a number of non-European Union based suppliers but it is relatively low compared to the number of suppliers who make B2C transactions in the European Union and all over the world.<sup>342</sup> Some non-European Union based suppliers have found it easier to establish their business in one member state and therefore levy only one VAT rate for their transaction as other European Union based suppliers.<sup>343</sup> It is difficult for compliance to be enforced under the scheme for the same reason why it was difficult prior to the scheme, because it is impossible to identify when supplies are made to European Union consumers.<sup>344</sup> The European Commission has identified that the successful implementation of the VAT rules is dependent on the voluntary compliance by non-

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<sup>338</sup> Article 58 Council Directive of 2008.

<sup>339</sup> Article 369a (1) Council Directive of 2008.

<sup>340</sup> DM Parrilli ‘European VAT and Electronically Supplied Services’ op cit note 277.

<sup>341</sup> Basu op cite note 320.

<sup>342</sup> Lamensch op cite note 313 at 7.

<sup>343</sup> DM Parrilli ‘European VAT and Electronically Supplied Services’ op cit note 277; Algirdas Semeta ‘The Mini-One Stop Shop for VAT – the Start of Something Big!’ (2012) *World Commerce Review*.

<sup>344</sup> Lamensch op cit note 313 at 7.

European Union suppliers.<sup>345</sup> There is currently no clear repercussions for non-compliance with the VAT rules under the scheme. The voluntary compliance relied on by the Commission is premised on the theory that non-European Union based suppliers will not risk exposure to significant and unresolved tax debts in the largest market in the world as this may damage its reputation, creditworthiness and liquidity.<sup>346</sup> Another incentive for compliance has been argued to be that of receiving intellectual property protection in the European Union<sup>347</sup> It is argued that a give and take motivation is not a viable method to ensure compliance in e-commerce.<sup>348</sup>

## 5. CONCLUSION

The above analysis of indirect taxation of e-commerce that was implemented in the European Union is a valuable example of the practical application of VAT rules to e-commerce. It shows that e-commerce can be indirectly taxed through the classification of digital products as a service and by deeming the place of supply of digital products to be place where they are consumed. However, the European Union VAT collection system is not perfect and has a number of inherent weaknesses.<sup>349</sup> The enforceability of VAT rules is prejudiced by the fact that tax authorities have to rely on voluntary compliance. The evasive nature e-commerce makes the determination of the identity and location of the customer and monitoring by tax authorities difficult. It is evident that there is a need for further development either on the technological front or on the rules themselves.

There is still a high number of problems associated with the registration scheme. Without clear solutions to these issues, and particularly that of enforcement in the European Union, it is questionable whether the South African system will be effective. Monitoring and enforcement of the scheme's provisions requires technological developments that are not yet available to tax authorities and that will be costly to develop. Parrilli argues that technology alone cannot solve the issues of

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<sup>345</sup> European Commission 'Green Paper on the Future of VAT: Towards a Simpler, More Robust and Efficient VAT System COM' (2010) 695 at 12.

<sup>346</sup> Fawkes op cit note 282 at 57.

<sup>347</sup> Van der Merwe op cit note 56 at 587.

<sup>348</sup> Ibid.

<sup>349</sup> Lamensch op cit note 313 at 20.

identification of the customer's location and suggests that place of supply rules should be reconsidered as well as the classification of the digital products as a service.<sup>350</sup> However, the European Union system follows the recommendations of the OECD, which offers the only framework for indirectly taxing e-commerce that would work in the international arena. It is more appropriate for South Africa to follow the OECD's framework and European Union's system than for it to deviate from either.

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<sup>350</sup> DM Parrilli 'European VAT and Electronically Supplied Services' op cit note 277.

# CONCLUSION

The indirect taxation and applicable collection methods for e-commerce has been the focus of this paper. The e-commerce business method and the cross-border transactions that occur within it were explained and the issues that it raises for the levying and collection of VAT were discussed. The guidelines and recommended methods of collection of indirect taxation offered by the OECD were then highlighted. This illustrated the framework of indirect taxation that can be adopted by a given jurisdiction. Thereafter, a discussion of the South African VAT system was embarked on and the previous methods of tax collection under this regime were discussed. Next, the new dispensation which was introduced into the South African VAT system was the focus of the next chapter. The new VAT amendments are said to be in line with international standards and so an investigation into the European Union's VAT system was embarked upon. While briefly summarising the key aspects of each chapter, the value of each chapter will be highlighted in conclusion.

E-commerce is a business method that has become part of the South African economy and the products and services that are traded in this digital economy are liable for VAT. Although there is no single definition of e-commerce and transactions can occur in different contexts (B2B, B2C or B2G), e-commerce can be allocated a definition for tax purposes.<sup>351</sup> The ability of international transactions to occur online introduces challenges, namely characterisation, identification of the customer and enforcement.<sup>352</sup> Although substantial, these are challenges that can be addressed by appropriate and clear legislation.

The OECD's guidelines and recommendations are aimed at tackling the problems that arise within international trade and the levying of indirect taxes by governments in relation to intangibles and services provided over the internet.<sup>353</sup> The OECD has maintained that e-commerce does not necessarily have to have separate legislation enacted, but provisions in tax jurisdictions should adjust current provisions to provide for the classification of digital content as a service or intangible; the place of supply to be where the recipient is located and where the

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<sup>351</sup> See Chapter 1.2. Different jurisdictions have adopted different definitions through the listing of specific e-commerce transactions.

<sup>352</sup> See Chapter 1.4.

<sup>353</sup> OECD International VAT/GST Guidelines 2006 op cit note 96.



supply is consumed; and lastly, the reverse-charge or self-assessment mechanism and the registration mechanism should be utilised as the main tax collection methods.<sup>354</sup>

The previous legislation governing Value Added Tax in South Africa had shortcomings which included that it did not have a clear definition of what digital content was; did not have specific place of supply rules with clear proxies to aid suppliers of electronic services in determining their VAT liability; further, the tax collection method of self-assessment or reverse-charge mechanism was inefficient as well insufficient to address situations where digital content was supplied to customers in South Africa.<sup>355</sup>

The VAT amendments have addressed the shortcomings of the self-assessment or reverse-charge mechanism and introduces legislation that now requires foreign suppliers of electronic services to register as vendors if they meet the minimum threshold of making R50 000 worth of supplies, within a calendar month.<sup>356</sup> This change is accompanied by VAT amendments to the definition of an ‘enterprise’, which now includes the supply of electronic services by a person or business outside of South Africa to a recipient in South Africa or where payment for the services comes from a South African bank and the introduction of the definition of ‘electronic services’ as specified by the Minister in the Regulation.<sup>357</sup>

It was stated that the new VAT amendments were introduced to address the concerns of local suppliers who considered themselves to be at a competitive disadvantage with regards to VAT not being declared and paid on purchases by South African consumers from foreign suppliers of electronic services.<sup>358</sup> The VAT amendments place a foreign supplier of electronic services that meets the registration criteria on the same footing as a local supplier of electronic service with respect to VAT obligations of a registered vendor. Thus eliminating the distortion in competition. The VAT amendments have also removed the provisions that allowed for VAT not to be paid on importation of services below the amount of R100 per

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<sup>354</sup> See Chapter 2.

<sup>355</sup> See Chapter 3.

<sup>356</sup> See Chapter 4.

<sup>357</sup> Ibid.

<sup>358</sup> National Treasury ‘Media Statement Electronic Services Regulations: Request for Public Comments’ op cit note 11.

invoice as VAT now has to be levied under s.7(1)(a) as the foreign supplier will be registered as a vendor.<sup>359</sup>

The certainty brought by the VAT amendments only extends to electronic services and suppliers thereof but in situations where services other than electronic services are supplied the rulings of the cases of *Metropolitan Life Limited v Commissioner for the South African Revenue Service*<sup>360</sup> and *Commissioner for the South African Revenue Service v De Beers*<sup>361</sup> still prevail for the determination of VAT liability and the reverse-charge mechanism will apply. The VAT amendments have focused on electronic services alone and have not amended the rules governing other imported services under s. 7(1)(c) of the VAT Act. In this regard the new place of supply rules do not apply, and Van Zyl<sup>362</sup> argues that the utilised-and consumed principle applies and the continued reliance on the reverse-charge mechanism as a method of enforcing VAT on imported services is impractical. The low compliance rate and the erosion of the tax base emphasise the urgency of implementing clear place-of-supply proxies.

The OECD's principles can be clearly identified in the VAT amendments introduced to the South African VAT legislation. Firstly, digital content has been confirmed as a service in the VAT Act.<sup>363</sup> Secondly, clarity has been provided with regard to when a foreign supplier of services, specifically electronic services, has to register as a VAT vendor in South Africa. A simplified registration process accompanies this new requirement.<sup>364</sup> Thirdly, place of supply rules have been adopted which include proxies which will help in determining whether the supply of electronic services has been consumed in South Africa.<sup>365</sup> However, South Africa has excluded the need for a supplier to identify the status of the customer by not distinguishing between B2B and B2C transactions,<sup>366</sup> therefore reducing this burden on the registered foreign supplier of electronic services. This is a deviation which

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<sup>359</sup> Section 14(5)(e) VAT Act.; Louw and Botha 'Value Added Tax on Electronic Services Supplied by Persons Outside South Africa' op cit note 268.

<sup>360</sup> (2008) 70 SATC 162 (C); discussed above in Chapter 3.2.1.

<sup>361</sup> 2012 (5) SA 344 (SCA); discussed above in Chapter 3.2.1.

<sup>362</sup> Van Zyl op cit note 212 at 553.

<sup>363</sup> Amendment Act 31 of 2013.

<sup>364</sup> Amendment Act 31 of 2013.

<sup>365</sup> Amendment Act 31 of 2013.

<sup>366</sup> SARS 'Response Document to the Taxation Laws Amendment Bill' op cit note 237 at 28.

may yet prove to be beneficial for both the tax authorities and registered foreign suppliers.

The European Union introduced the non-resident vendor registration system more than a decade before South Africa. The E.U system offers a satisfactory example of how the OECD principles function in practice. The system requires a non-EU supplier selling to private customers to register as an EU VAT vendor in any of the EU states, and must charge the customer the VAT rate levied in the state where the customer resides.<sup>367</sup> Thereafter the VAT collected and paid to the tax authorities where the non-EU vendor is registered, will be paid to the relevant government where the customer resides.<sup>368</sup> The EU registration system, however, does not apply a minimum threshold for registration, and a single sale to a consumer in the E.U triggers a requirement to register.<sup>369</sup> South Africa has included a minimum registration threshold and this makes it less burdensome for smaller foreign suppliers of electronic services than that of the E.U.

The problems that the E.U has encountered in the implementation of the registration system are lessons for South Africa to learn from and to try and avoid. The differences between the two systems cannot be ignored. The E.U is a collection of jurisdictions, while South Africa is a single jurisdiction, which allows South Africa to address complications and issues with the system more efficiently than the E.U can.

In conclusion the above has alluded to the reasons why the South African government has made VAT amendments to the VAT legislation so as to efficiently tax e-commerce. They have been guided by international principles on consumption taxes and examples set by the European Union. The capacity to monitor and control whether all foreign suppliers of electronic services that are obligated to register depends on SARS's effectiveness in implementing this new legislation and only time can tell.<sup>370</sup> However, South Africa has taken an active step forward by enacting this legislation and it can only be presumed that it will continue to take all necessary steps to ensure that it indirectly taxes e-commerce transactions in South Africa.

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<sup>367</sup> Article 26c Council Directive 2002/38/EC of May 2002.

<sup>368</sup> Article 26c Council Directive 2002/38/EC of May 2002.

<sup>369</sup> See in Chapter 3.2.1.

<sup>370</sup> C Watson 'VAT on Electronic Services and the Fiscus' op cit note 20.

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